

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF HAWAII

In the Matter of the Application)
)
 of)
)
 KAUAI ISLAND UTILITY COOPERATIVE)
)
 For Approval to Simultaneously)
 Change its Depreciation Accrual)
 Rates and Remove the Lost Gross)
 Margin Component from its 2005)
 Resource Cost Adjustment)
 (DSM & IRP) Surcharge.)
 _____)

DOCKET NO. 05-0033

DIV. OF CONSUMER AFFAIRS
EPT. OF COMMERCE AND
CONSUMER AFFAIRS
STATE OF HAWAII

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DECISION AND ORDER NO. 21865

Filed June 14, 2005
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Karen Higashi.
Chief Clerk of the Commission

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

K. Higashi.

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF HAWAII

In the Matter of the Application))	
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Resource Cost Adjustment))	
(DSM & IRP) Surcharge.))	
_____))	

DECISION AND ORDER

By this Decision and Order, the commission approves KAUAI ISLAND UTILITY COOPERATIVE's ("KIUC") request¹ to simultaneously utilize the depreciation accrual rates set forth in the "Book Depreciation Study for Kauai Island Utility Cooperative, dated May 17, 2004" ("Depreciation Study")² and remove the lost gross margin component from its 2005 Resource Cost Adjustment (DSM & IRP) Surcharge ("DSM & IRP Surcharge"), effective July 1, 2005, subject to certain conditions, described herein.

¹KIUC's application, filed on February 4, 2005 ("Application").

²KIUC's Depreciation Study was initially filed with the commission on June 7, 2004 in accordance with Decision and Order No. 19658, filed on September 17, 2002, in Docket No. 02-0060, and is attached to KIUC's Application as Exhibit A.

I.

Introduction

A.

Procedural History

On February 4, 2005, KIUC filed an Application seeking commission approval on or before June 30, 2005, to allow KIUC to, commencing as of July 1, 2005, simultaneously utilize the depreciation accrual rates in accordance with the Depreciation Study and remove the lost gross margin component from its DSM & IRP Surcharge, pursuant to Decision and Order No. 21567, filed on January 27, 2005, in Docket No. 04-0368 ("Order No. 21567").³ On March 4, 2005, the commission filed Stipulated Scheduling Order No. 21671 setting forth the procedural schedule in the instant proceeding. By letter dated March 11, 2005, the DIVISION OF CONSUMER ADVOCACY, DEPARTMENT OF COMMERCE AND CONSUMER AFFAIRS ("Consumer Advocate") requested a modification to the procedural schedule that delayed the filing of the Consumer Advocate's information requests from March 11, 2005 to March 18, 2005, with KIUC's responses due on April 1, 2005 instead of March 30, 2005.⁴

On March 18, 2005, the Consumer Advocate filed its information requests to KIUC. On April 1, 2005, KIUC filed its response to the Consumer Advocate's information requests. On April 11, 2005,

³The commission ordered KIUC to, among other things, file an application for approval of its current depreciation rates within three (3) weeks from the issuance date of Decision and Order No. 21567.

⁴On March 22, 2005, the commission granted the Consumer Advocate's request.

the Consumer Advocate filed its supplemental information requests. KIUC filed its responses to the Consumer Advocate's supplemental information requests on April 15, 2005.

On May 16, 2005 the Consumer Advocate filed its Statement of Position recommending that the commission approve KIUC's request to terminate the recovery of Lost Gross Margins in KIUC's DSM & IRP Surcharge and simultaneously approve KIUC's proposed depreciation rates. In addition, the Consumer Advocate recommended that KIUC be required to separately record the accumulated future net salvage amounts from the accumulated capital cost recovery amounts that are recovered through the proposed depreciation rates, consistent with the requirements of Federal Energy Regulatory Commission ("FERC") Order No. 631.

B.

Background

KIUC is a non-profit cooperative association. By Decision and Order No. 19658, filed on September 17, 2002, as amended by Decision and Order No. 19755, filed on October 20, 2002, in Docket No. 02-0060, the commission approved KIUC's purchase of substantially all of the assets of the Kauai Electric division of Citizens Communications Company ("Kauai Electric"), an investor-owned utility (aka, IOU). Accordingly, since November 1, 2002, KIUC has been operating as a public utility engaged in the production and delivery of electric energy on the island of Kauai in the state of Hawaii, using the same rates and tariffs as that used by its IOU predecessor, Kauai Electric.

Every year, KIUC's DSM & IRP Surcharge is adjusted to reflect the current costs to be recovered over the next twelve (12) month period (e.g., lost gross margins, DSM program costs, etc). Thus, in an application filed on December 31, 2003, in Docket No. 03-0422, KIUC requested commission approval to revise the DSM & IRP Surcharge for the 2004 calendar year.

In Decision and Order No. 20793, filed on February 4, 2004, in Docket No. 03-0422, the commission approved the requested change for a period of six (6) months (i.e., from February 1, 2004 to July 31, 2004), instead of the requested twelve (12) month period, so that the commission could submit information requests to KIUC for the purpose of analyzing the rationale of a cooperative collecting lost gross margins (which is a component of KIUC's DSM & IRP Surcharge). In connection with the above, the commission submitted information requests to KIUC on March 30, 2004. In response to the commission's information requests, KIUC explained the effects on KIUC and its members including, but not limited to, lower margins assigned to members, lower financial performance ratios such as Times Interest Earned Ratio, Debt Service Coverage and KIUC's Equity to Assets ratio, increased lender scrutiny, slower build-up of equity, and lower or delayed patronage capital refunds to members.

KIUC requested that it be allowed to continue to collect Lost Gross Margins pending KIUC's completion of its Equity Management Plan required by the commission pursuant to Decision and Order No. 20691, filed on November 26, 2003, as

clarified by Order No. 20708 filed on December 5, 2003, both in Docket No. 03-0223 (which approved KIUC's purchase of a twenty-six (26)⁴ megawatt combustion turbine electric generation facility).

Accordingly, in Order No. 20960, filed on May 4, 2004, in Docket No. 03-0422, the commission stated its concern with allowing the cooperative to continue collecting lost gross margins, however, the commission decided that the matter would be evaluated in KIUC's Equity Management Plan and proposed Integrated Resource Plan Framework to be filed by December 2004 and extended KIUC's 2004 Resource Cost Adjustment Surcharge through January 31, 2005.

KIUC filed its Equity Management Plan and proposed Integrated Resource Plan Framework on December 15, 2004 and December 23, 2004, respectively. On December 23, 2004, KIUC submitted its Application in Docket No. 04-0368 requesting commission approval of certain changes to its tariff to reflect KIUC's proposed 2005 DSM & IRP Surcharge. In KIUC's December 23, 2004 Application, KIUC requested that, due to the adverse financial impacts that the isolated removal of Lost Gross Margins from KIUC's DSM & IRP Surcharge would have on KIUC and its members, the commission refrain from making any adjustments to its 2005 DSM & IRP Surcharge with respect to Lost Gross Margins unless, or until, a simultaneous adjustment is also allowed to reflect KIUC's proposed change in its depreciation accrual rates in order to mitigate and offset these adverse financial impacts.

On January 27, 2005, the commission issued Order No. 21567 approving the requested tariff change in Docket No. 04-0368 for a period of six (6) months (i.e., from February 1, 2005 through July 31, 2005) without addressing the lost gross margin issue to allow time for KIUC to file an application for approval of its current depreciation rates, as represented in its December 23, 2004 Application.

In accordance with Order No. 21567, KIUC filed the instant Application in Docket No. 05-0033 ("Request for Approval").

II.

KIUC's Request for Approval

As previously mentioned, KIUC seeks to simultaneously utilize the depreciation accrual rates in accordance with the Depreciation Study and remove the lost gross margin component from its DSM & IRP Surcharge.

KIUC's Depreciation Study is based on December 31, 2003 plant and accumulated depreciation balances. The proposed depreciation rates were calculated on a straight-line broad group remaining life basis, consistent with the method, procedure, and technique used in the 1993 depreciation study. KIUC conducted statistical service life and dispersion pattern studies as a basis for the service life recommendations. Certain net salvage value studies were also conducted. The results of both studies produced the parameters used to calculate the depreciation rates.

These parameters consisted of a projection life, a dispersion pattern defined by an Iowa Curve, and a future net salvage value. The projection life and Iowa Curve were used to calculate an estimated remaining life. Next, the remaining life and net salvage ratio were used to calculate the remaining life depreciation rates based on December 31, 2003 plant and accumulated balances. The proposed depreciation rates result in an annual depreciation expense of \$12 million, which is \$2 million less than the expense at the current depreciation rates.

KIUC further represents that the positive impacts of allowing it to utilize the new depreciation accrual rates set forth in the Depreciation Study more than offset the negative financial impact on KIUC and its members from the elimination of KIUC's collection of the Lost Gross Margin Component of its DSM & IRP Surcharge. KIUC further represents that by implementing the two (2) changes simultaneously, KIUC and its members will not experience any negative financial impacts from the non-collection of Lost Gross Margins, and KIUC will have the opportunity to achieve the equity targets set forth in Appendix B of the Equity Management Plan.

III.

Consumer Advocate's Position

Concerning KIUC's proposed depreciation rates, the Consumer Advocate concludes that the depreciable life proposals in KIUC's Depreciation Study appear to be reasonable. However, the Consumer Advocate also raises concerns with KIUC's inclusion of the future net salvage ratios in the proposed depreciation rates for several, but not all, accounts. Specifically, the Consumer Advocate asserts that the future net salvage ratios are all negative, which increases the depreciation rates for estimated future cost of removal expenditures by \$2.2 million. Thus, by excluding the future net salvage ratios from KIUC's proposed depreciation rates, the Consumer Advocate contends that KIUC's depreciation expense would be reduced by \$4.2 million, as opposed to the \$2 million, as projected by KIUC.

The Consumer Advocate notes that FERC Order No. 631 addresses the appropriateness of including future net salvage ratios in determining depreciation rates. In sum, it does not require the reclassification of the future net salvage values from accumulated depreciation to a regulatory liability. Instead, FERC Order No. 631 merely requires separate specific identification of the future net salvage allowances that are included in depreciation expense and the associated accumulated depreciation balances. To address this concern, the Consumer Advocate recommends that KIUC separately identify the future net salvage value component in KIUC's proposed depreciation rates and account for the amounts recovered through the

depreciation expense, consistent with the requirements of the FERC Order No. 631. KIUC, in response to such concern, states that it does not object to the separate accounting recommended by the Consumer Advocate.⁵ As a result, the Consumer Advocate states that it does not object to the commission's approval of KIUC's proposed depreciation rates, as reflected in its Depreciation Study, subject to this qualification.

Concerning Lost Gross Margins, the Consumer Advocate states that it supports KIUC's proposal to terminate the recovery of Lost Gross Margins in its DSM & IRP Surcharge. The Consumer Advocate notes: (1) that KIUC's members are also customers of the cooperative; thus, there is no longer a need to compensate the members for the lost gross margins resulting from the lost sales due to the installation of DSM measures; (2) existing market and industry conditions have changed to where, even without recovery of a lost gross margin incentive, it is in KIUC's best interest to implement cost-effective DSM programs; and (3) governmental statutes such as the State Energy Policy and Renewable Portfolio Standards require KIUC to implement cost-effective DSM programs.

IV.

Discussion

Upon review of the record, we agree with the Consumer Advocate's conclusions and recommendation relating to KIUC's proposed depreciation accrual rates set forth in the

⁵See KIUC response to CA-SIR-1.

Depreciation Study. Accordingly, the commission concludes that KIUC's proposed depreciation accrual rates should be approved, subject to the condition that KIUC should be required to separately identify the future net salvage value component in KIUC's proposed depreciation rates and account for the amounts recovered through the depreciation expense consistent with the requirements of FERC Order No. 631. Finally, because KIUC's and the Consumer Advocate's concerns relating to depreciation rates have been appropriately addressed, we will allow KIUC to simultaneously utilize the depreciation accrual rates set forth in the Depreciation Study, and remove the Lost Gross Margin Component from its DSM & IRP Surcharge, effective July 1, 2005, as proposed by KIUC. KIUC's proposal is expected to effectively retain the existing revenue stream by simultaneously reducing the depreciation expense with the approved depreciation rates while terminating the collection of Lost Gross Margins through its IRP & DSM Surcharge. These changes should mitigate and/or offset any potential adverse financial impacts to KIUC and, at the same time, address the concerns of a cooperative collecting Lost Gross Margins, as stated in Order No. 20960, in Docket No. 03-0422.

IV.

Orders

THE COMMISSION ORDERS:

1. KIUC's proposed depreciation accrual rates set forth in the Depreciation Study are approved.

2. KIUC may simultaneously utilize the approved depreciation accrual rates set forth in the Depreciation Study, and remove the Lost Gross Margin Component from its 2005 Resource Cost Adjustment (DSM & IRP) Surcharge, effective July 1, 2005.

3. KIUC shall separately identify the future net salvage value component in KIUC's proposed depreciation rates and account for the amounts recovered through the depreciation expense consistent with the requirements of FERC Order No. 631.

4. KIUC shall file with the commission, in Docket No. 04-0368, the appropriate tariff sheets, consistent with the terms and conditions of this Decision and Order with an effective date of July 1, 2005, within seven (7) days of the date of this Decision and Order. Further commission action will follow in Docket No. 04-0368.

5. This docket is closed unless otherwise ordered by the commission.

DONE at Honolulu, Hawaii JUN 14 2005.

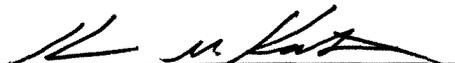
PUBLIC UTILITIES COMMISSION
OF THE STATE OF HAWAII

By 
Carlito P. Caliboso, Chairman

By (EXCUSED)
Wayne H. Kimura, Commissioner

By 
Janet E. Kawelo, Commissioner

APPROVED AS TO FORM:



Kevin M. Katsura
Commission Counsel

05-0033.eh

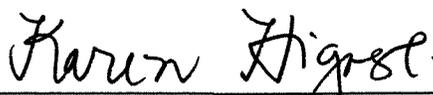
CERTIFICATE OF SERVICE

I hereby certify that I have this date served a copy of the foregoing Decision and Order No. 21865 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
DIVISION OF CONSUMER ADVOCACY
P. O. Box 541
Honolulu, HI 96809

DUTCH ACHENBACH
KAUAI ISLAND UTILITY COOPERATIVE
4463 Pahe'e Street
Lihue, HI 96766-2032

KENT D. MORIHARA, ESQ.
ISHIKAWA, MORIAHA, LAU & FONG, LLP
Davies Pacific Center
841 Bishop Street, Suite 400
Honolulu, HI 96813



Karen Higashi

DATED: JUN 14 2005