BEFORE THE PUBLIC UTILITIES COMMISSION

OF THE STATE OF HAWAII

In the Matter of the Application of)) HAWAIIAN ELECTRIC COMPANY, INC.) HAWAII ELECTRIC LIGHT COMPANY, INC.) MAUI ELECTRIC COMPANY, LIMITED)) For Approval to Record a Regulatory) Asset for Any Pension Liability) Which Would Otherwise be Charged) to Accumulated Other Comprehensive) Income.))	DOCKET NO. 05-0310

DECISION AND ORDER NO. 23223

Filed Jan. 26, 2007

At 2 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.

Karen Higashi

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DECISION AND ORDER

By this Decision and Order, the commission denies HAWAIIAN ELECTRIC COMPANY, INC. ("HECO"), HAWAII ELECTRIC LIGHT COMPANY, INC. ("HELCO"), and MAUI ELECTRIC COMPANY, LIMITED's ("MECO")[1] request to record as a regulatory asset pursuant to the Financial Accounting Standards Board's ("FASB") Statement of Financial Accounting Standards ("SFAS") No. 71 the amount that would otherwise be charged to equity as required under the provisions of SFAS No. 87 or SFAS No. 158[2] as a result of recording a minimum pension liability.

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[1]The Parties in this proceeding are: (1) HECO, HELCO, and MECO, collectively referred to as the "HECO Companies"; (2) the Department of Commerce and Consumer Affairs, Division of Consumer Advocacy, an ex officio party, pursuant to Hawaii Revised Statutes ("HRS") § 269-51 and Hawaii Administrative Rules ("HAR") § 6-61-62(a); and (3) the DEPARTMENT OF THE NAVY, on behalf of the DEPARTMENT OF DEFENSE ("DOD").

[2](1) SFAS No. 71, Accounting for the Effects of Certain Types of Regulation; (2) SFAS No. 87, Employers' Accounting for Pensions; and (3) SFAS No. 158, Employers' Accounting for Defined

I.

Background

A.

Parties

HECO and HELCO are the franchised providers of electric utility service on the islands of Oahu and Hawaii, respectively. MECO is the franchised provider of electric utility service for the County of Maui. Hawaiian Electric Industries, Inc. ("HEI") is the parent entity of the HECO Companies.

The DOD maintains numerous military installations statewide that utilize electrical power furnished by HECO and HELCO. The Consumer Advocate represents all consumers of electric utility service.

B.

Application

On December 8, 2005, the HECO Companies filed an application[3] requesting commission approval to allow the HECO Companies: (1) to record as a regulatory asset the amount that would otherwise be charged to accumulated other comprehensive income ("AOCI"), as required under SFAS No. 87 as a result of recording a minimum pension liability; (2) to continue to record as a regulatory asset in subsequent years the amount that would otherwise be charged directly to AOCI; and (3) to continue to

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Benefit Pension and Other Postretirement Plans, an Amendment of FASB Statements Nos. 78, 88, 106, and 132(R).

[3]Application; Verification; Certificate of Service; and Exhibits 1 - 4, filed on December 8, 2005 (collectively, "Application").

recover their annual cost of providing pension benefits to their employees, as actuarially calculated under SFAS No. 87.[4]

The HECO Companies request commission approval of their Application by January 16, 2007, and in any event, no later than January 30, 2007, in order to meet their external disclosure filing deadlines.[5] The HECO Companies maintain that obtaining the commission's timely approval to record a regulatory asset for the amounts that would otherwise be charged to equity as a result of the Pension Plan's underfunding is a "very important issue" for them.[6]

C.

Issues

As set forth in Stipulated Procedural Order No. 23012 filed on November 3, 2006, the issues in this proceeding as agreed-upon by the Parties are:

1. Whether the [HECO] Companies should be allowed to record as a regulatory asset pursuant to SFAS No. 71 the amount that would otherwise be charged to equity as required under the provisions of SFAS No. 87 or SFAS

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[4]The HECO Companies filed their Application pursuant to HAR § 6-61-74, HRS § 269-6, "and other applicable requirements." See Application, at 2. The HECO Companies served copies of their Application upon the Consumer Advocate.

[5]See HECO Companies' responses to CA-IR-2(d), CA-IR-3(b), and CA-SIR-5(c); HECO Companies' letter, dated December 6, 2006, at 3 - 4; and HECO Companies' Reply Statement of Position, at 7 - 8. The HECO Companies state that a commission decision issued after January 31, 2007, will impact: (1) their scheduled closing for January 2007; and (2) HEI's ability to timely file its 2006 Form 10-K with the federal Securities and Exchange Commission. HECO Companies' letter, dated December 6, 2006, at 4.

[6]HECO Companies' letter, dated December 6, 2006, at 3 and 5. See also id. at 4.

No. 158 as a result of recording a minimum pension liability ["Issue No. 1"].

2. Whether the [HECO] Companies should be allowed to continue to maintain in subsequent years, a regulatory asset, for any pension liability that would otherwise by charged to equity ["Issue No. 2"].

3. Whether the [HECO] Companies should be allowed to continue to recover [their] annual cost of providing pension benefits to [their] employees, as actuarially calculated under the provisions of SFAS No. 87 ["Issue No. 3"].

Stipulated Procedural Order No. 23012, Section I, Statement of Issues, at 3.[7]

D.

HECO Companies' Position

The HECO Companies provide pension benefits to certain of their current and former employees by participating in the Retirement Plan for Employees of HEI and Participating Subsidiaries ("Pension Plan" or "Plan"), a qualified defined benefit pension plan, under the provisions of the federal

[7]On November 17, 2006, the HECO Companies filed a letter with the commission: (1) summarizing the information provided in their responses to the Consumer Advocate's information requests and supplemental information requests; (2) updating their Application, including their requested relief, by incorporating the changes in accounting as a result of SFAS No. 158, issued on September 29, 2006; and (3) modifying the Statement of the Issues set forth in Section I of Stipulated Procedural Order No. 23102 ("Summary Letter").

On November 29, 2006, the Consumer Advocate informed the commission that it objected to the HECO Companies' proposal to modify the Statement of Issues. The DOD did not comment on the HECO Companies' modifications to the Statement of Issues.

On December 6, 2006, the HECO Companies withdrew their modifications to the Statement of Issues, and confirmed that the requested relief is the same as the relief initially requested in their Application.

Employee Retirement Income Security Act ("ERISA"). The Pension Plan's assets are held by its trustee, The Bank of New York. The pension fund is a separate entity from the HECO Companies, and is operated solely for the benefit of the participants in the Pension Plan. A Pension Investment Committee is the named fiduciary for the Pension Plan and is responsible for overseeing the administration of the Plan. The Pension Plan's assets are managed by professional fund managers.

While the Pension Plan's assets are commingled for all participating employers, the assets and liabilities of each participating employer are separated for purposes of determining each employer's pension costs, which is the annual amount the HECO Companies must recognize on their financial statements as the cost of providing pension benefits to their employees for the year.

1.

Accounting and Reporting Requirements

a.

SFAS No. 71

"[U]nder SFAS 71, it is acceptable for the [HECO Companies] (if explicitly approved by the Commission) to recognize assets, which would have otherwise been recognized as costs, if regulation provides assurance that those costs will be recovered in the future. SFAS 71 specifically provides accounting guidance for regulated public utilities whose rates (prices) are set (by the regulator) at levels intended to recover

the regulated public utilities' costs of provided services or products, including the cost of capital. The accounting treatment proposed by the [HECO Companies] is in accordance with [Generally Accepted Accounting Principles, aka] GAAP."[8]

b.

SFAS No. 87

The HECO Companies' accounting and reporting requirements with respect to the Pension Plan are recorded in accordance with GAAP, specifically under the guidance of SFAS No. 87. Under SFAS No. 87, the costs of the benefits provided by the HECO Companies' Pension Plan are recognized as net periodic pension costs ("NPPC") over the period the benefits are earned (i.e., as employees provide the related employment services). The NPPC is the annual amount the HECO Companies must recognize on their financial statements as the cost of providing pension benefits to their employees for the year, and includes amounts ultimately charged to both expense and capital. For ratemaking purposes, the commission has allowed the HECO Companies to recover their NPPC in their electric rates.[9]

The cash amount the HECO Companies contribute to the Pension Plan may differ from the NPPC, and will take into account factors such as the minimum contribution required under ERISA, and the maximum contribution that is deductible under the

[8]HECO Companies' response to CA-IR-8(b) (emphasis added). See also HECO Companies' response to CA-SIR-13(c); and Consumer Advocate's Statement of Position, at 7 and 25.

[9]See HECO Companies' Application, at 5 n.2; see also HECO Companies' Reply Statement of Position, at 5 n.6.

Internal Revenue Code (and therefore, not subject to a 10% non-deductible excise tax). Under SFAS No. 87, a prepaid pension asset is created when fund contributions exceed the NPPC on a cumulative basis.

The fair value of the Pension Plan assets represents the estimated market value of the fund at the measurement date, which is December 31 for the HECO Companies. The accumulated benefit obligation ("ABO") approximates the actuarial present value of benefits previously earned by participants at the measurement date.

Under SFAS No. 87, if the fair value of the pension fund assets of the Pension Plan is less than the ABO at the measurement date, it results in a change in the accounting treatment. Thus, under SFAS No. 87, if the ABO exceeds the fair value of the pension fund assets at the measurement date (by as little as $1): (1) a liability, at least equal to the difference between the ABO and the fair value of the pension fund assets, is recognized; (2) any prepaid pension asset is eliminated; and (3) a charge, net of income taxes (which will represent a net loss not yet recognized as NPPC) shall be reported as a charge directly to a component of equity, known as AOCI.

The amount of AOCI net of the minimum pension liability amount will essentially be the prepaid pension asset, net of income taxes. SFAS No. 87 requires that the minimum pension liability be adjusted at each re-measurement date thereafter, to

the extent the ABO continues to exceed the fair value of its Pension Plan assets.[10]

Under SFAS No. 87, the recognition of a minimum pension liability will also require that any prepaid pension asset be eliminated and that each utility's equity be reduced by an amount equal to its prepaid pension asset plus the minimum pension liability.

c.

SFAS No. 158

On September 29, 2006, FASB issued SFAS No. 158, which amended SFAS Nos. 87, 88, 106, and 132(R), but did not change the calculation of the NPPC. Under SFAS No. 158, the HECO Companies are required to: (1) recognize the overfunded or underfunded status of their defined benefit pension and other post-retirement plans based on the difference between the fair value of the respective plan assets and projected benefit obligation ("PBO") for pensions and the accumulated post-retirement benefit obligation ("APBO") for other post-retirement plans in the balance sheet; (2) recognize as a component of AOCI, net of tax, the actuarial gains and losses, the prior service costs and credits that arise during the period but are not recognized as components of net periodic pension cost, and any remaining

[10] "The charge to AOCI, if any, would be partially or fully reversed in future periods if and to the extent that the value of the pension plan assets equals or exceeds the ABO or through the recognition of NPPC in future periods. Thus, any minimum pension liability will eventually be reversed upon improvement in pension plan asset returns and interest rate environment or be reversed via higher net periodic pension costs in future years." HECO Companies' Application, at 6 n.3.

transition obligation from the initial application of SFAS No. 87; and (3) disclose additional information in the notes to financial statements about certain effects on the NPPC.

SFAS No. 158 requires the recognition of the funded status of defined benefit pension plans measured as the difference between the fair value of the Pension Plans' assets and PBO as opposed to the ABO. Under SFAS No. 158, the PBO is defined as the actuarial present value of pension benefits attributed to service already rendered, measured using assumptions as to future compensation levels. Because the PBO is significantly larger than the ABO, based on this new measurement, it is probable that the HECO Companies will be required to record a significant liability equal to the underfunded status of their Pension Plans, and record a charge, net of tax, to AOCI.

2.

HECO Companies' Arguments

The HECO Companies contend that the proposed regulatory asset treatment is reasonable and consistent with GAAP as promulgated by SFAS No. 71. The HECO Companies explain that: (1) from a financial reporting perspective, they maintain their financial statements in accordance with GAAP, which includes SFAS No. 87, No. 158, and No. 71; and (2) their proposed accounting treatment is consistent with GAAP, since the regulatory asset will be recorded under the provisions of SFAS No. 71. In support thereto, the HECO Companies state:

1. SFAS No. 71 provides accounting guidance that will allow the HECO Companies to account for certain items based on the economics of regulation and the decisions of regulators. Specifically, "[t]he determination of whether an amount can be recorded as a regulatory asset is based on the probability of whether the asset will be recoverable via electric rates in the future."[11]

2. The commission has approved the HECO Companies' adoption of SFAS No. 87 for ratemaking purposes.[12]

3. While the recordation of the Pension Plans' probable underfunded status will be non-cash balance sheet changes and will not impact the income statement, the HECO Companies' equity and rate base amounts will be significantly impacted. A significant charge to AOCI, as a result of recording a minimum pension liability, will adversely affect the HECO Companies.

4. "If the [HECO] Companies are required to record substantial charges to AOCI, the [HECO] Companies' financial ratios [will] deteriorate, which could result in security ratings downgrades and/or difficulty (or greater expense) in obtaining future financing. In addition, there could be financial covenant violations. Also, if the prepaid pension assets that the [HECO] Companies have been allowed to include in their rate bases for

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[11]HECO Companies' Application, at 13.

[12]See HECO Companies' Application, at 5 n.2.

ratemaking purposes are eliminated, then the [HECO] Companies' reported rates of return on rate base [will] be higher."[13]

5. An AOCI adjustment will result in an artificial increase in the HECO Companies' return on average common equity and rate of return on rate base, since the [HECO] Companies' equity and rate base will decrease significantly, without any change in economic conditions or increase in net income.

6. The regulatory treatment is consistent with the Federal Energy Regulatory Commission's ("FERC") accounting guidelines.[14]

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[13]HECO Companies' Application, at 10. See also HECO Companies' letter, dated November 17, 2006, at 6.

[14]The HECO Companies specifically refer to FERC's Public Notice, entitled Recognition of a Regulatory Asset for Minimum Pension Liability, dated March 29, 2004, which states in part:

> Question: At the time the entity recognizes its minimum pension liability in accordance with SFAS No. 87, should it recognize a regulatory asset for the amount of the liability otherwise chargeable to accumulated other comprehensive income that relates to its cost based rate-regulated business segment?
>
> Response: . . . .
>
> Under [FERC's] accounting requirements regulatory assets are to be established for those charges that would have been included in net income or accumulated other comprehensive income determinations in the current period under the general requirements of the Uniform System of Accounts but for it being probable that such items will be included in a different period(s) for purposes of developing rates that the utility is authorized to charge for its utility services.
>
> Therefore, in circumstances described above and provided that it is probable that the pension allowance to be included in rates in future periods will continue to be calculated on the basis of SFAS No. 87, entities shall recognize a regulatory asset for the minimum pension liability otherwise chargeable to accumulated other

7. The recognition of a regulatory asset, as opposed to a charge to AOCI, has been approved in other jurisdictions for which utility companies in which their ABO exceeded their pension plans assets, based on reasons similar to those set forth in the Application.[15]

8. The HECO Companies are not seeking any change in their rates as a result of their request, and the companies' current rates will remain unaffected. According to the HECO Companies:

> . . . . The [HECO] Companies would include in their rate base calculation the regulatory asset, as well as the minimum pension liability and related deferred income taxes. The net of the regulatory asset, minimum pension liability, and related deferred income taxes would be essentially the prepaid pension asset amount currently reflected in the [HECO] Companies calculation of

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> comprehensive income related to its cost based rate regulated business segments.
>
> Further, the minimum pension liability, as well as, any related regulatory asset is not amortized over future periods. At each measurement date, the entry recorded for the previous measurement date is reversed and the computation redone. A new minimum liability and related regulatory asset would be recognized, if required, at the new measurement date.
>
> This guidance is for accounting purposes only and does not limit [FERC] from reviewing the reasonableness of the elements of pension expense included in future rate proceedings before [FERC].

HECO Companies' Application, Exhibit 4, at 2 - 3 (106 FERC ¶ 62,230) (emphasis added).

[15]See HECO Companies' Application, at 14 n.11.

their rate bases.[16] The regulatory treatment of the pension liability, instead of a charge to equity, will not affect the amount or timing of any present or future pension expense recordation as each year's pension costs, and contributions will continue to be recorded in accordance with SFAS No. 87. If in future years the fair value of the [HECO] Companies' Pension Plan assets exceeds its ABO, the [HECO] Companies would reverse the remaining minimum pension liability and the regulatory asset, including related deferred income taxes and restore the prepaid pension asset and related deferred income taxes, if any.

Although the [HECO] Companies were not required to make any contributions to the plan in 2003 and 2004, the [HECO] Companies made contributions in order to primarily sustain a prepaid pension asset rather than a charge to AOCI. The regulatory accounting treatment proposed above would allow the [HECO] Companies to avoid making such additional contributions in the future.

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[16]Currently, the HECO Companies' prepaid pension assets are included in their respective rate bases since the amount of investor-funded contributions exceeds the pension plan's accumulated NPPC. Investors have provided this advanced funding to the Pension Plan, which will result in lower NPPC in the future, and are entitled to earn a fair and reasonable return on these funds . . . . Although the recordation of minimum pension liabilities will also require the removal of the HECO Companies' prepaid pension assets from their balance sheets for financial reporting purposes, the adjustments are non-cash entries. Further, the HECO Companies would include in their rate base calculations the regulatory asset as well as the minimum pension liability, as the net of these components would essentially be the prepaid pension asset amount currently reflected in the Companies' calculations of rate base. If the commission determines in its final Decision and Order in Docket No. 04-0113, to exclude the prepaid pension asset from rate base, the HECO Companies will exclude the regulatory asset as well as the minimum pension liability from rate base.

HECO Companies' Application, at 15 (footnote and text therein retained).[17]

E.

Consumer Advocate's Position

On December 8, 2006, the Consumer Advocate filed its Statement of Position[18] in which it reiterates its opposition in In re Hawaiian Elec. Co., Inc., Docket No. 04-0113 (HECO's 2005 test year rate case) to HECO's proposed inclusion of a prepaid pension asset in its test year rate base;[19] notes the

[17]In 2005, the HECO Companies also made contributions to the Pension Plan, in part to avoid the risk of a charge to AOCI if the ABO exceeded the fair market value of the qualified pension plan assets at December 31, 2005. HECO Companies' letter, dated February 9, 2006. At December 31, 2005, the fair market value of the plan assets exceeded the ABO.

[18]Consumer Advocate's Statement of Position; and Certificate of Service, filed on December 8, 2006 (collectively, "Consumer Advocate's Statement of Position").

[19]By Interim Decision and Order No. 22050, filed on September 27, 2005, in Docket No. 04-0113, the commission approved an increase in HECO's rates, "on an interim basis, to such levels as will produce, in the aggregate, $53,288,000, in additional revenues for test year 2005 (4.36 per cent more than at present rates)." The commission found that HECO was probably entitled to an interim increase in its rates, to be in effect from the date of Interim Decision and Order 22050, until the issuance of the commission's final decision and order in Docket No. 04-0113.

In Interim Decision and Order No. 22050, the commission also made preliminary rulings on the three issues in dispute, including the issue of whether to include a prepaid pension asset in HECO's rate base (net of an adjustment to accumulated deferred income tax ("ADIT") reserve). The Consumer Advocate and the DOD objected to HECO's proposed inclusion of $78,791,000 of prepaid pension asset in rate base. For purposes of Interim Decision and Order No. 22050, the commission held that "HECO [was] probably entitled to include the $78,791,000 in prepaid pension asset in rate base, with a corresponding adjustment of $28,483,000 for the ADIT reserve. At this juncture, a cursory review of the record

inter-relationship between the pension accounting for financial statement issues in this proceeding and the prepaid pension asset issue in Dockets No. 04-0113 and No. 05-0315, and the need to view these issues in conjunction with one another; notes the complexity of pension accounting for financial reporting purposes, particularly when the issue of the proper regulatory accounting for pensions is folded into the process; and notes that accounting for financial statement purposes can differ from accounting done for regulatory and ratemaking purposes.[20]

The Consumer Advocate states that while SFAS No. 71 authorizes regulated companies the flexibility to follow accounting practices that differ from the accounting practices that other companies must follow to be in accordance with GAAP, "[g]enerally, regulatory authority must be granted to a regulated company to utilize such alternative procedures before any such alternative accounting procedures can be implemented for public financial statement disclosure purposes. For this reason, in order for the [HECO] Companies to employ the proposed use of a regulatory asset in lieu of a charge to AOCI, the [HECO]

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appears to indicate that the amounts contributed to the pension plan were not imprudent."

[20]The Consumer Advocate states that "there are times that financial statement and regulatory accounting procedures should be different to properly balance the regulated company's needs to properly and adequately disclose the financial condition of the company against the need to protect ratepayers' interests." Consumer Advocate's Statement of Position, at 8. In other words, "while a particular methodology may be required for financial accounting purposes, it should not be assumed that regulatory accounting should automatically follow suit. The accounting for a prepaid pension asset is one example of a situation where it should not be assumed that regulatory accounting should follow financial statement accounting." Id.

Companies must first obtain Commission approval. If approval is not granted, the [HECO] Companies will not be able to use such alternative accounting procedures."[21]

1.

Consumer Advocate's Objections to the Application

With the exception of Issue No. 3, the Consumer Advocate objects to the commission's approval of the HECO Companies' Application.[22] The Consumer Advocate's opposition to the requested relief (Issue Nos. 1 and 2) is that the HECO Companies' requests, if approved in this regard, will have the HECO Companies' investors having the best of both worlds, to the ratepayers' detriment.[23]

In essence, the Consumer Advocate contends that when the fair value of the Pension Plan exceeds the PBO, the HECO Companies expect to reflect a prepaid pension asset and include the asset in their test year rate base. Conversely, when the PBO exceeds the fair value of the Pension Plan: (1) the HECO Companies, by this docket, seek commission approval to create a regulatory asset to offset the minimum pension liability instead

[21]Consumer Advocate's Statement of Position, at 7.

[22]With respect to Issue No. 3, the Consumer Advocate clarifies that it "does not object to the Commission confirming that the Companies can continue to recover its annual cost of providing pension benefits, as actuarially calculated under the provision of SFAS No. 87, with the clarification that the Consumer Advocate reserves the right to review the reasonableness of the pension expense included in the revenue requirement for future rate proceedings." Consumer Advocate's Statement of Position, Section III, at 47.

[23]Consumer Advocate's Statement of Position, Section II(B), at 8 - 11.

of taking a charge to AOCI; and (2) the regulatory asset will be reflected in future rate proceedings as an addition to rate base.[24] The HECO Companies' proposals (Issue Nos. 1 and 2), in the Consumer Advocate's view, are absurd, clearly unacceptable, and should be rejected by the commission.

Based on its underlying contention, the Consumer Advocate further asserts:

1. The "regulatory asset" at issue does not represent a cash expenditure or the application of cash, nor is it an item that is used by the HECO Companies to provide electric utility service.[25]

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[24]"When the PBO exceeds the fair value of the Pension Plan, the [HECO] Companies [will] not reflect the activity on the income statement - only the balance sheet is affected. However, rather than reflect a charge (i.e., debit) to the AOCI, the [HECO] Companies are requesting that they be allowed to record the charge (i.e., debit) as a regulatory asset. Thus, the regulatory asset would offset the new minimum pension liability recorded on the balance sheet." Consumer Advocate's Statement of Position, at 9.

[25]As explained by the Consumer Advocate:

> If it is determined that the Pension Plan is underfunded, the [HECO] Companies expect ratepayers to provide the [HECO] Companies with a return on the shortfall (i.e., the reconciling balance which they seek to record as a regulatory asset). This is in spite of the fact that the [HECO] Companies are not out-of-pocket for even a dime of that balance. It should be made clear that while the term "asset" might be used to describe the balance, the "asset" is not a revenue generating item (unless the Commission allows it to be one by including the asset in rate base). It also does not represent a cash expenditure or application of cash, nor is it an item that is used to provide utility service. The regulatory asset that would be created under the FASB requirements for pension accounting simply exists <u>in lieu of a charge to AOCI</u> representing a reconciling difference between the actuarially calculated obligations (PBO) of the [HECO] Companies and the available funds of the Pension Plan.

2. Both the prepaid pension and regulatory assets, if allowed, are balances that simply reflect reconciling items used for financial statement reporting purposes. There is no economic or financial value to these assets, unless the commission allows them to be included in the utility's rate base.[26]

3. The HECO Companies' assertion that an unfavorable ruling will adversely affect future credit ratings are unsupported.[27] Notwithstanding the ability of certain regulated companies to seek regulatory approval to deviate from the requirements of SFAS No. 87 and No. 158, all companies that must follow GAAP will be affected by the requirements of SFAS No. 87 and No. 158. Thus, as acknowledged by the HECO Companies, the rating agencies should be aware of this fact.[28] "As such, if all companies are affected equally, there should be no increased risk for one company as compared to others - the requirements of SFAS Nos. 87 and 158 are the same on all applicable companies. . . . All companies, whether regulated or not, face the same accounting requirements and the same potential need to record a charge to AOCI."[29]

Consumer Advocate's Statement of Position, at 10 (emphasis in original).

[26]Consumer Advocate's Statement of Position, Section II(C), at 12 - 13.

[27]Consumer Advocate's Statement of Position, Section II(C)(1), at 13 - 21.

[28]The Consumer Advocate cites to the HECO Companies' response to CA-IR-15(b).

[29]Consumer Advocate's Statement of Position, at 14.

4. Moreover, "[i]f a company has properly and adequately funded its pension plan, most charges to AOCI should not represent a significant event. If a company has properly funded its pension plan and a significant charge to AOCI is required, such [a] charge is most likely due to adverse financial market returns, which [will] likely affect all companies in a similar manner."[30]

5. As confirmed by the HECO Companies, the charge to AOCI, if required, represents a non-cash transaction.[31] In particular, the transaction does not require the outlay of any cash or the recognition of an expense that might affect the net income reported for that year.

6. The HECO Companies' assertion that an unfavorable ruling will result in only a short-lived benefit and higher costs (NPPC and cost of capital) are misleading.[32]

7. The HECO Companies' assertion that investors will be harmed is a mischaracterization of the situations that might exist due to pension accounting requirements.[33]

8. Contrary to the HECO Companies' position, an unfavorable ruling will not adversely affect their ability to

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[30]Consumer Advocate's Statement of Position, at 14 - 15.

[31]The Consumer Advocate cites to the HECO Companies' responses to CA-IR-14(d) and CA-IR-15(d)(2).

[32]Consumer Advocate's Statement of Position, Section II(C)(2), at 21 - 22.

[33]Consumer Advocate's Statement of Position, Section II(C)(3), at 22 - 31.

attract and retain employees.[34] Rather, "the Commission's decision on the relief sought in the instant proceeding will not directly affect the Pension Plan or the [HECO] Companies' ability to attract and retain employees."[35]

9. While other jurisdictions have approved the proposed accounting treatment, such approval was usually coupled with conditions and limited to financial statement purposes only, and did not constitute regulatory authorization of any future ratemaking treatment of the costs associated with the regulatory asset.[36]

10. Even if the commission authorizes the HECO Companies to record a regulatory asset in lieu of a charge to AOCI, that authority will not extend to their affiliated companies (HEI and American Savings Bank), which must still follow GAAP.[37] "Thus, if conditions warrant, it is still likely that the [HECO] Companies' consolidated financial statements would reflect a charge to AOCI because the unregulated affiliates would not be able to resort to alternative accounting procedures under SFAS No 71 as the [HECO] Companies are seeking . . . . That being said, . . . the Consumer Advocate urges the Commission to consider the reasonableness of allowing the [HECO] Companies to

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[34]Consumer Advocate's Statement of Position, Section II(C)(4), at 31 - 33.

[35]Consumer Advocate's Statement of Position, at 33 (emphasis added).

[36]Consumer Advocate's Statement of Position, Section II(E), at 35 - 37.

[37]Consumer Advocate's Statement of Position, Section II(G), at 39 - 40.

avoid taking a charge to AOCI by recording a regulatory asset, when the [HECO] Companies' consolidated financial statements would have to reflect such a charge."[38]

2.

Conditions

The Consumer Advocate emphasizes that the HECO Companies are seeking commission approval to not only record a regulatory asset instead of a charge to AOCI when there is a measured underfunding of the Pension Plan, but are also seeking pre-approval to include the regulatory asset in rate base in future rate cases.

In the event the commission is inclined to approve the HECO Companies' requested relief, the Consumer Advocate recommends that the commission impose the following conditions:

- The authority to record a regulatory asset in lieu of a charge to AOCI when either or both the pension and PBOP plans are underfunded under the guidelines offered in SFAS No. 158 is limited to financial statement purposes. The [HECO] Companies should **not** be allowed to recognize the regulatory asset in rate base when setting rates. Such treatment should not require a write-off of the regulatory asset, assuming that the Commission continues to allow the [HECO] Companies to follow SFAS No. 87 when determining the costs associated with providing pension plans and allowing the actuarially calculated costs to be reflected when setting rates.

- Any decision in this proceeding will not guarantee any specific amount or provide the determination of how costs associated with

[38]Consumer Advocate's Statement of Position, Section II(G), at 39 - 40.

the pension plans are recovered in future utility rates.

- If the Commission grants a departure from the requirements of SFAS Nos. 87 and 158, this should also apply to the recognition of the prepaid pension asset when setting rates. That is, if a regulatory asset in lieu of a charge to AOCI should be allowed, then neither the regulatory asset nor the prepaid pension asset should be recognized when setting rates. . . .

- If the requested accounting procedures are going to be allowed, there should be an upper threshold to the amount that can be reflected as a regulatory asset. The reason for this recommendation is that, if a regulatory asset is required to be recorded, that means that the Pension Plan is underfunded. If the [HECO] Companies are allowed to book a regulatory asset, as opposed to taking a charge to AOCI, there is a reduced incentive to ensure that the Pension Plan is properly funded. While the [HECO] Companies should be expected to strive to keep the Pension Plan properly funded, allowing the use of a regulatory asset in lieu of a charge to AOCI and including the regulatory asset in rate base, reduces the incentive that would help to encourage proper funding. Thus, if the deviation from SFAS Nos. 87 and 158 is to be allowed, the Commission should not allow the [HECO] Companies to record a regulatory asset that exceeds 5% of the Pension Plan assets attributable to that company. If an amount larger than 5% of the Pension Plan is required to be reflected as a regulatory asset, then it is probably time for the [HECO] Companies to explain the conditions that caused the underfunding and the plan to ensure that the proper funding levels are attained.

. . . .

- . . . the Consumer Advocate acknowledges that additional measures may be required on a going forward basis. One of those measures may be a tracking or reconciling mechanism to facilitate the equitable and reasonable treatment of the contributions made, the sources of the contributions and the associated reporting requirements.

. . . .

> It should be made clear that the Consumer Advocate is not proposing that the Commission approve any such tracking mechanism at this time. Instead, it would seem more appropriate to implement any such mechanism in the context of a ratemaking proceeding, where the Commission and Consumer Advocate can consider the calculated NPPC, the pension expense to be included in rates, the accumulated funds, the sources of those funds, etc. If a determination is to be made in the instant proceeding, the Commission should seriously consider the reasonableness of a tracking mechanism that will properly distinguish the amounts that need to be recovered through rates, if any, from the amounts that simply need to be reflected in financial statements in order to comply with GAAP.

Consumer Advocate's Statement of Position, at 41 - 43, 46 (footnotes and citations therein omitted) (boldface and emphasis in original).

E.

DOD's Position

On December 7, 2006, the DOD filed its Statement of Position,[39] in which it emphasizes that the ratemaking treatment of the regulatory assets being requested by the HECO Companies is

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[39]DOD's Statement of Position; and Certificate of Service, filed on December 7, 2006 (collectively, "DOD's Statement of Position").

By Order No. 22883, filed on September 21, 2006, the commission granted the DOD's motion to intervene. The DOD filed its motion to intervene on December 27, 2005, and on January 6, 2006, the HECO Companies filed their opposition to the DOD's motion. See DOD's Motion to Intervene; and Certificate of Service, filed on December 27, 2005; and HECO Companies' Memorandum in Opposition to the Motion to Intervene of DOD; and Certificate of Service, filed on January 6, 2006.

not being addressed or decided in this proceeding.[40] Based on this understanding, the DOD does not object to the HECO Companies' requested relief, subject to the following conditions:

1. As noted above, no ratemaking treatments regarding rate base inclusion of a regulatory asset or impacts on capital structure are being addressed or decided in this proceeding.

2. No pre-approval is being given for recovery of any specific amount of pension or OPEB expense in future rates, and the Commission policies and precedents on what constitutes a recoverable operating expense are not being changed.

3. The [HECO] Companies should be required to undertake an analysis, and to present it in their subsequently filed rate cases, sufficient to determine whether ratepayers are better off with a well-funded pension plan, a minimally-funded pension plan, or something in between. The funding plan should include a discussion of the various funding alternatives, including maximum tax-deductible funding, and a long-term economic analysis that demonstrates why the [HECO] Companies' preferred funding method is the most beneficial to ratepayers. The economic analysis should include any assumptions used for determining expense and funding levels.

4. The provision allowing the [HECO] Companies to continue to recover the annual cost of providing pension and OPEB benefits to its employees, as actuarially calculated under

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[40]As stated by the DOD, "[t]he ratemaking treatment of the regulatory assets being requested by the [HECO] Companies, including whether such asset is includable in rate base is a matter that should be left for specific case-by-case analysis in the [HECO] Companies' respective upcoming rate cases." DOD's Statement of Position, at 2.

The DOD also notes that "[w]hether HECO's prepaid pension asset had been funded by shareholders or ratepayers, and hence whether it should be allowed to be included in rate base and earn a rate of return is an important issue under consideration by the Commission in Docket No. 04-0113[,]" HECO's pending 2005 test year rate case. DOD's Statement of Position, at 2.

> the provisions of SFAS Nos. 87 and 158 for pensions and SFAS Nos. 106 and 158 for OPEBs, respectively, must be subject to review in each company's rate case.

DOD's Statement of Position, at 4.

F.

HECO Companies' Reply

On January 12, 2007, the HECO Companies filed their Reply Statement of Position[41] in which they reiterate the arguments they previously made, and emphasize that they are not requesting that the ratemaking treatment of the regulatory asset be addressed in this proceeding. Instead, the HECO Companies maintain that this issue will be addressed in Docket No. 05-0315, HELCO's pending 2006 test year rate case, Docket No. 2006-0386, HECO's pending 2007 test year rate case, and Docket No. 2006-0387, MECO's forthcoming 2007 test year rate case.[42] Moreover, "[t]he [HECO] Companies acknowledge that future rate cases may include review of the reasonableness of the specific amounts of pension costs as actuarially calculated in accordance with SFAS No. 87."[43]

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[41]HECO Companies' Reply Statement of Position; and Certificate of Service, filed on January 12, 2007 (collectively, "Reply Statement of Position").

[42]In other words, the HECO Companies stress that they are not requesting that any specific amounts of pension costs be recovered in this proceeding. Thus, commission approval of the HECO Companies' Application does not mean that the regulatory asset is includable in rate base for ratemaking purposes.

[43]HECO Companies' Reply Statement of Position, at 11.

With respect to the Consumer Advocate and the DOD's overall concerns over the proper funding of the Pension Plan, the HECO Companies state their willingness to undertake and complete by May 31, 2007, a HECO/HELCO/MECO pension funding study for submission in Docket No. 2006-0386, HECO's pending 2007 test year rate case, as long as no delay in HECO's rate case results.[44]

Lastly, the HECO Companies state that they "will continue to work with the Consumer Advocate and the DOD to develop a supplemental procedural schedule for the conduct of discovery and filing of supplemental statements of position for the OPEB portion of amounts that would be charged to AOCI as a result of SFAS No. 158."[45]

II.

Discussion

A.

Issues No. 1 and No. 2

The HECO Companies seek the commission's approval of certain entries related to pension accounting. In particular, they seek to record a regulatory asset, in lieu of reflecting a charge against a component of equity, AOCI.[46] In seeking the

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[44]HECO Companies' Reply Statement of Position, at 14 and 17 - 18.

[45]HECO Companies' Reply Statement of Position, at 18.

[46]In general, this matter arises under GAAP for AOCI. If the HECO Companies' request is not approved, the HECO Companies will have to reflect the charge against AOCI in accordance with SFAS No. 87, as part of recording a minimum pension liability, i.e., reflecting a charge to AOCI when the anticipated pension obligations exceed the assets held in the pension fund.

commission's approval in this regard, the HECO Companies explain that they have discussed the proposed accounting treatment with their external auditors, who confirm that "[i]n order for the [HECO Companies] to record as a regulatory asset, the amount that would otherwise be charged to AOCI as required under SFAS 158 as a result of recording an underfunded status liability of the Plans, the Commission must explicitly allow the [HECO Companies] to continue to recover their annual cost of providing the Plans' benefits to their employees, as actuarially calculated under the provisions of SFAS [87]. This would provide assurance that incurred costs will be recovered in the future thus supporting regulatory asset treatment under SFAS 71."[47]

The commission recognizes that this docket is not a ratemaking proceeding or rate case. Thus, while the HECO Companies' assertion that this docket will not change or affect its current utility rates is true, this "same assertion cannot be made with respect to the setting of rates in the future."[48] The HECO Companies have requested that "the regulatory asset (if conditions result in the regulatory asset being recorded) [be included] in the calculation of rate base in future rate proceedings[,]" which means that "if the regulatory asset is reflected as an addition to rate base, the utility rates will be

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The HECO Companies seek approval to implement their requested alternative accounting procedure any time that an amount will be charged directly to AOCI as a result of SFAS No. 87.

[47]HECO Companies' response to CA-IR-6(a).

[48]Consumer Advocate's Statement of Position, at 37.

higher in future rate proceedings than if the regulatory asset was not recognized."[49] In this way, the HECO Companies' request is different from the commission decisions it cites in support of approval of its Application.[50]

In addition, the commission is not persuaded by the HECO Companies' unsubstantiated claim that if they are required to record substantial charges to AOCI, the HECO Companies' financial ratios will deteriorate, possibly leading to security downgrades and difficulty (and greater expense) in obtaining future financing (and detrimentally affecting their authorized rates of return).

As noted by the Consumer Advocate, the HECO Companies acknowledge that: (1) since the filing of their application, they have not discussed with the rating agencies whether a charge to AOCI will result in a ratings downgrade;[51] (2) based on their conversation with a rating agency in October 2004, the rating agency viewed the charge to AOCI as being in accordance with accounting standards that have no impact on cash, and as such,

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[49] Id.

[50] Most of the commission decisions cited by the HECO Companies in their Application focused on the approval for financial reporting purposes rather than for inclusion in rate base. See Consumer Advocate's Statement of Position, at 36. Moreover, the commission decisions relied upon by the HECO Companies, see HECO Companies' Application, at 14, n.11, which allowed the regulatory treatment proposed by the HECO Companies in this docket, did not appear to scrutinize the applicants' claims as thoroughly as the New Jersey Board of Public Utilities' contrary decision. Id. at n.12; and HECO Companies' response to DOD-IR-8, Attachment 4. Nonetheless, the commission finds that none of the commission decisions cited by the HECO Companies are dispositive, given the unique circumstances that exist here.

[51] HECO Companies' responses to CA-IR-15(d)(1) and CA-SIR-1(a).

the agency did not plan on taking further action;[52] (3) the HECO Companies determined that it was not necessary to follow-up with the rating agency;[53] and (4) the charge to AOCI, if required, represents a non-cash transaction.[54] In other words, the regulatory asset created under the FASB requirement for pension accounting does not constitute a monetary expenditure or the application of cash.[55] Moreover, the HECO Companies, in their Application, acknowledge that with respect to any possible financial covenant violations, there are no advances currently outstanding under any credit facility subject to financial covenants.[56]

In addition, the commission concurs with the Consumer Advocate's assessment that: (1) SFAS No. 87 and No. 158 will affect all companies that adhere to GAAP; (2) the rating agencies should be aware of this fact; and (3) if all companies are equally affected, there should be no increase in risk for one company in comparison with other companies. Thus, the HECO Companies' claim that the denial of their requested relief could detrimentally impact their credit rating is not sufficiently substantiated or supported by the record.

Based on the foregoing reasons, the commission finds that the HECO Companies have not met their burden of proof for

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[52]HECO Companies' response to CA-IR-15(d)(2).

[53]HECO Companies' response to CA-IR-15(d)(3).

[54]HECO Companies' responses to CA-IR-14(d), CA-IR-15(d)(2), and DOD-IR-11(a), Attachment 1, page 2.

[55]Consumer Advocate's Statement of Position, at 10.

[56]HECO Companies' Application, at 11.

Issue No. 1. Accordingly, the commission answers Issue No. 1 in the negative. The commission's decision to deny Issue No. 1 renders moot Issue No. 2.

B.

Issue No. 3

Issue No. 3 amounts to a request for a declaratory ruling that the HECO Companies, as they have been allowed in past rate cases, may recover their annual costs of providing pension benefits to its employees, as actuarially calculated under the provisions of SFAS No. 87. However, given the commission's other rulings in this docket, there is no need to address the issue at this time as the requested declaratory ruling was needed to allow the HECO Companies to recognize regulatory assets by providing regulatory assurance that those costs will be recovered in the future as required under SFAS 71. Furthermore, as stated above, this is not a ratemaking proceeding or rate case and this issue is more appropriately the subject of the HECO Companies' pending rate cases. Accordingly, the commission declines to grant the relief requested under Issue No. 3.

C.

Pension Study

Despite its decisions on Issue Nos. 1 and 2, the commission finds useful and consistent with the public interest the HECO Companies' proposal to undertake and complete by May 31, 2007, a HECO/HELCO/MECO pension study for submission in Docket

No. 2006-0386, HECO's pending 2007 test year rate case. As proposed by the HECO Companies, the pension study will "determine whether ratepayers are better off with a well-funded pension plan, a minimally-funded pension plan, or something in between."[57] Accordingly, the commission will require the HECO Companies to complete a pension study for submission in Docket No. 2006-0386 by May 31, 2007.

III.

Orders

THE COMMISSION ORDERS:

1. The HECO Companies' request to record as a regulatory asset pursuant to SFAS No. 71 the amount that would otherwise be charged to equity as required under the provisions of SFAS No. 87 or SFAS No. 158 as a result of recording a minimum pension liability (Issue No. 1) is denied.

2. The HECO Companies' request to maintain in subsequent years, a regulatory asset, for any pension liability that would otherwise be charged to equity (Issue No. 2) is denied as moot.

3. The HECO Companies' request for a declaratory ruling that they will be allowed to continue to recover their annual cost of providing pension benefits to their employees, as actuarially calculated under the provisions of SFAS No. 87 (Issue No. 3) is dismissed without prejudice.

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[57]HECO Companies' Reply Statement of Position, at 14.

4. The HECO Companies shall undertake and complete a pension study for filing in Docket No. 2006-0386, HECO's pending 2007 test year rate case, by May 31, 2007.

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

DONE at Honolulu, Hawaii JAN 2 6 2007.

PUBLIC UTILITIES COMMISSION
OF THE STATE OF HAWAII

By
Carlito P. Caliboso, Chairman

By
John E. Cole, Commissioner

APPROVED AS TO FORM:

Michael Azama
Commission Counsel

05-0310.sl

CERTIFICATE OF SERVICE

I hereby certify that I have this date served a copy of the foregoing Decision and Order No. 23223 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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