BEFORE THE PUBLIC UTILITIES COMMISSION

OF THE STATE OF HAWAII

In the Matter of the Application of)) HAWAIIAN ELECTRIC COMPANY, INC.)) For Approval of (1) the Commitment) of Funds in Excess of $2,500,000) for the Purchase and Installation) of the RO Water Pipeline Project) and the Environmental Monitoring) Project, (2) a Rate Reduction) Program, (3) Accounting and) Ratemaking Treatment of the) RO Water Pipeline Project and) Environmental Monitoring Project,) all as Part of the Community) Benefits Package Relating to) Item Y-49000, Campbell Industrial) Park Generating Station and) Transmission Additions Project.))	DOCKET NO. 05-0146

DECISION AND ORDER NO. 23514

Filed June 27, 2007

At 10 o'clock A. 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 approves the Joint Motion for Approval of Stipulation filed by HAWAIIAN ELECTRIC COMPANY, INC. ("HECO") and the DEPARTMENT OF COMMERCE AND CONSUMER AFFAIRS, DIVISION OF CONSUMER ADVOCACY ("Consumer Advocate")[1] on November 22, 2006 ("Joint Stipulation").

[1]The Consumer Advocate is an ex officio party to this docket pursuant to Hawaii Revised Statutes ("HRS") § 269-51 and Hawaii Administrative Rules ("HAR") § 6-61-62. HECO and the Consumer Advocate are the only parties to this docket and will hereinafter be referred to as the "Parties."

In doing so, the commission approves: (1) HECO's request to commit funds in excess of $2,500,000 for the purchase and installation, and subsequent dedication to the City and County of Honolulu Board of Water Supply ("BWS"), of a Reverse Osmosis ("RO") water pipeline from Campbell Industrial Park ("CIP") to HECO's Kahe Power Plant and related facilities ("RO Water Pipeline Project"), in accordance with Paragraph 2.3.g.2 of the commission's General Order No. 7, Standards for Electric Utility Service in the State of Hawaii ("G.O. No. 7"); (2) HECO's request to commit funds in accordance with G.O. No. 7 for the purchase and installation of equipment needed for HECO's proposed Air Quality Monitoring Program and Fish Monitoring Program (jointly, "Environmental Monitoring Programs"); and (3) HECO's proposed accounting and ratemaking treatment of the RO Water Pipeline Project and Environmental Monitoring Programs, all as a part of a "Community Benefits Package" relating to Item Y-49000, Campbell Industrial Park Generating Station and Transmission Additions Project ("CIP Generating Station Project").[2]

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[2]The CIP Generating Station Project was recently approved by the commission in Decision and Order No. 23457, filed on May 23, 2007, in Docket No. 05-0145. That project will add approximately 110 megawatts ("MW") of peaking generating capacity on HECO's system, helping to meet HECO's existing demand and forecasted future system load growth on the island of Oahu. Specifically, HECO intends to construct a new 110 MW simple-cycle combustion turbine or "CT" at its existing Barbers Point Tank Farm facility located in CIP in West Oahu. HECO, in an attempt to work cooperatively with the communities in West Oahu and minimize the

The commission, however, denies HECO's request to implement a rate reduction program, whereby HECO proposes to offer a rate discount on the base energy charge for residential ratepayers who live in the 96707 zip code ("Residential Rate Reduction Program"), another component of the Community Benefits Package, described herein.

In other words, the commission approves the RO Water Pipeline Project and Environmental Monitoring Programs of HECO's Community Benefits Package, but denies the Residential Rate Reduction Program. In doing so, the commission commends HECO for its innovative, cooperative approach in engaging the local communities in West Oahu and attempting to amicably resolve their concerns related to the CIP Generating Station Project. The commission finds that the RO Water Pipeline Project and the Environmental Monitoring Programs are reasonable, sound results of that collaborative process that appear likely to benefit not only the local communities, but all ratepayers on the island of Oahu. In contrast, the commission finds that the Residential Rate Reduction Program is not a reasonable component of the Community Benefits Package and is inconsistent with the public

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risk of extended litigation over the CIP Generating Station Project, initiated a discussion process with local community members in West Oahu, the outcome of which was the Community Benefits Package that forms the basis for this docket.

interest and applicable law, and accordingly, finds that it should be denied.

I.

Background

A.

Application

HECO is a Hawaii corporation organized under the laws of the Kingdom of Hawaii on or about October 13, 1891, and now exists 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.

On June 17, 2005, HECO filed its application,[3] requesting that the commission approve: (1) the commitment of funds for the proposed RO Water Pipeline Project, pursuant to G.O. No. 7; (2) the commitment of funds for the Environmental Monitoring Programs, pursuant to G.O. No. 7; (3) the accounting and ratemaking treatment of the RO Water Pipeline Project and Environmental Monitoring Programs; and (4) the Residential Rate Reduction Program, all as a part of the Community Benefits

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[3]See HECO's Application, Exhibits A-F, Verification, and Certificate of Service, filed on June 17, 2005 ("Application").

Package relating to the CIP Generating Station Project. The Community Benefits Package is further described below.

1.

Community Benefits Description and Development

HECO explains that "community benefits" or "community givebacks" are something that is given to a community that has been impacted to address a harm that is being caused to a specific community on behalf of a larger society.[4] In other words, community benefits provide something positive to a community for a "burden" they are taking on.[5] HECO understands that the concept of a Community Benefits Package is "somewhat of a new idea in Hawaii's utility regulatory arena," but HECO asserts that community benefits are a natural progression of the concept of mitigation measures relating to specific capital improvement projects that have been approved by the commission in the past.[6]

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[4]See HECO T-1 at 7.

[5]See id.

[6]For example, HECO cites the approximately $5.0 million for the undergrounding conversion of distribution lines that was approved by the commission as a mitigation measure in the Waiau-CIP 138 kilovolt ("kV") Part 2 Transmission Line Project. See HECO's Opening Brief, filed on January 8, 2007 ("HECO's O.B.") at 3.

According to HECO, "[t]he Community Benefits Package is the culmination of a long process that had its genesis in several events[.]"[7] HECO discussed its prior experience in siting infrastructure projects as one of the factors that lead to its decision to adopt a new approach, through the community benefits process, of engaging local communities that would be affected by the CIP Generating Station Project:

> The placement of infrastructure projects in our communities is a process that has changed a great deal over the years. There was a day when most communities accepted the intrusions and burdens that could result from the siting of infrastructure facilities (i.e., power plants, landfills) in their area as a fact of life. They were not necessarily happy about the projects but they did not fight the projects.
>
> All of that has undergone dramatic change in recent years. For Hawaiian Electric, in the past, this included the Waiau-CIP 138 kV line, Part 2; the Keahole Generation Station Expansion; and the Wa`ahila Ridge controversy. Communities have become much more involved in these projects, much more insistent on understanding both the reasons for a project and the alternatives to it, and much more resistant to accepting additional infrastructure . . . . We have learned as a company, often through bitter experience, that if we do not take the time to personally sit with communities to talk about proposed projects, we run the very real risks of protracted and ugly disputes and quite possibly, a rejection of the proposed project. Even though two of the three examples mentioned above (Waiau-CIP 138 kV line, Part 2 and the Keahole

[7] Id. at 6.

> Generation Station Expansion) are now installed and in operation, and the third is being reviewed as a new alignment (Waahila Ridge controversy - East Oahu Transmission Line Project), the extra time and resources expended to address these disputes and protracted litigation over a number of years was extensive. As a result, we have gone into more recent processes (i.e., the Waiau Fuel Pipeline, the Kahe Wind process, and the CIP Generation Station) with a very different approach. Because of the critical need for generation and our obligation to serve, we cannot afford to have the proposed CIP project delayed or placed in limbo because of protracted litigation. The potential ramifications are immense.[8]

HECO also stated that the community benefits approach arose out of discussions relating to Hawaii's energy policy. In this regard, HECO explained that, in early 2002, the University of Hawaii at Manoa Hawaii Energy Policy Forum ("Energy Forum"), which HECO described as "a unique experiment in collaborative energy planning and policy making," was formed.[9] The Energy Forum included representatives from business, government, and the community in an effort to incorporate many different perspectives into the design of an energy strategy. The Energy Forum identified six critical studies to support the development of energy strategy. One of the studies related to social, cultural and economic issues.

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[8]HECO T-1 at 7-9.

[9]HECO's O.B. at 8.

In December 2003 and January 2004, the Energy Forum formed a sub-group called the Community Impacts Group, to begin the process of identifying, understanding, and addressing issues related to the impact of infrastructure placement in communities. HECO further described the underlying purpose of the Community Impacts Group, as well as its recommendations:

> Invited participants primarily consisted of residents of those communities familiar with hosting such [infrastructure] facilities, as it was clearly evident that major infrastructure projects are unevenly distributed across Oahu's communities and that only a few communities bear the brunt of the impact (identified by the Community Impacts Group to include impacts such as aesthetics, natural and cultural resources and possible negative health consequences) resulting from these types of projects. For example, most of Oahu's power plants and landfill sites are located along the Leeward coast of Oahu. These burdens are exacerbated when general planning models are applied to Hawaii without taking into account Hawaii's distinctive geographic, cultural and social differences. Thus, in determining the location of new major infrastructure facilities, the Community Impacts Group suggested that the decision making process should include input from the impacted communities from development to evaluation of the proposed project and allow for full disclosure of risks and benefits, clearly delineated boundaries and limits, interagency cooperation and ongoing monitoring and evaluation. Most importantly, the community consultation process should give the most weight to the communities most likely to be directly impacted by the proposed facility.[10]

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[10]HECO T-1 at 13-14.

As a result of the work of the Community Impacts Group and the discussions that HECO was holding in the West Oahu community concerning a possible wind farm in the mountains above the Kahe Power Plant, HECO stated that it knew it needed to meet with the neighboring communities of the CIP Generating Station Project to discuss the unit and its potential impact on the communities.

2.

Community Benefits Process

HECO states that, beginning in the summer of 2004, it began discussing the new CIP Generating Station Project with the neighboring communities. Meetings with individuals, speeches to community and business groups, and meetings with the Neighborhood Boards of Makakilo/Kapolei/Honokai Hale, Waianae, and Ewa, focused on describing the energy situation on Oahu and meeting Oahu's energy needs. As a result of all of those meetings, HECO was given the following protocol to follow:

1. Tell the communities about HECO's planned proposals before HECO announces its proposals to the general public.

2. Ask communities for permission for HECO's activities.

3. Understand that communities may oppose HECO.

4. If the communities agree with HECO's proposals or if the communities are unsuccessful in opposing HECO, the affected communities and HECO need to discuss possible ways of giving back to the communities for the burdens being imposed on the communities.

5. HECO needs to ask the communities about the form of the givebacks.[11]

HECO believed that it had met the first three requirements with respect to the CIP Generating Station Project. HECO therefore asked the community to initiate the "giveback" discussions contemplated in steps four and five of the above protocol. In this regard, HECO states that, from February 2005 to June 2005, HECO had dozens of meetings on a one-to-one basis with elected officials and community leaders and other individuals in the communities of Ewa Beach, Makakilo, Kapolei, and Waianae to explain HECO's plans and the need for the proposed unit. HECO also held five group meetings with the various leaders from the foregoing communities, who HECO collectively refers to as the "Community Group."[12] HECO

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[11]See id. at 15.

[12]HECO attached as Exhibit B to the Application, a list of the invited participants and their attendance at the five "Community Group" meetings. HECO maintains that the individuals who comprised the Community Group were identified during HECO's outreach process. See Transcript of Proceedings held on November 29, 2006 ("Tr.") at page 12, lines 16-18. Hereinafter, citations to the Transcript will be in the following format: Tr. at 12:16-18. HECO described the Community Group as "a who's who of community activists in the Waianae Coast/Makakilo

represents that the meetings with the Community Group resulted in a consensus that, while the CIP Generating Station Project may well be necessary, "givebacks" to the community should be an essential part of any package to install new generation at CIP.

Overall, the Community Group came up with seventeen different "giveback" proposals that were discussed between the Community Group and HECO, including: (1) the closure of Kahe Power Plant; (2) reducing the environmental footprint of Kahe Power Plant; (3) providing solar panels to Leeward schools; (4) providing combined heat and power units to all schools in the area; (5) building a hospital or a full-service clinic in the West Oahu area; (6) undergrounding the utility wires along Farrington Highway; (7) assisting in building affordable housing; and (8) beautifying Farrington Highway.[13]

HECO states that the Community Group adhered to the following guiding principles in working on the Community Benefits Package:

> (1) The Community Benefits Package needs to do something to directly address the immediate neighbors of the new plant.

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area," whose right to be heard on community issues had been established by decades of community work. Id. at 130:16-17, 12:21-24.

[13]Exhibit C, attached to the Application, lists all of the suggested community givebacks and an initial analysis of each proposal.

(2) The Community Benefits Package needs to take action to reduce the environmental impact of existing facilities, especially the Kahe Power Plant.

(3) The Community Benefits Package should encourage change in the way people live on this island - there needs to be an ethic that recognizes and appreciates the limits of living in an island community and that conserves resources such as air, water, and land.

(4) The Community Benefits Package should provide information - hard data - on the environmental conditions in the areas around HECO's power generating facilities.

(5) HECO should be accountable to the community for the assurances and promises it has made the community in terms of the following:

a) The actions that would be taken to reduce the use of power through conservation and energy efficiency programs;

b) The actions that would be taken to promote the use of renewable energy;

c) The mitigation of environmental impacts caused by power generation.

(6) The community and HECO should create a process and working relationship between HECO and the community that can then be held out to others who come into the community as a model, a template, for future work.[14]

HECO further represents that the Community Group and HECO acknowledged that providing givebacks would clearly raise

[14]HECO T-1 at 19-20.

the question of when givebacks were appropriate. In this regard, HECO believes that the following criteria are appropriate in determining when discussions on potential givebacks should occur:

(1) The facility to be placed in the community triggers an automatic Environmental Impact Statement ("EIS") under HRS Chapter 343, such as a new large fossil fuel power generating facility;

(2) The new facility is critical to Hawaii's economy and Hawaii's community at large and there are no viable alternatives to locate the facility. Projects which may not be eligible for givebacks have viable alternatives and/or while their denial would create some level of harm, it would not necessarily be devastating if they were denied;

(3) The neighborhood of the new facility already has a substantial number of facilities that serve the general public that would be considered undesirable such as oil refineries, large wastewater facilities, large fossil fuel power generating facilities, landfills, oil off-loading and storage facilities, and coal off-loading and storage facilities;

(4) The facility location is constrained by land use designations and zoning;

(5) The benefits of the facility go substantially to the general population, and not primarily to those who live nearby the new facility; and

(6) "Givebacks" would help to mitigate the burdens borne by those in the neighborhood of the new facility for the benefit of the general population.[15]

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[15] Id. at 21-22.

HECO clarifies that it is not asking the commission to approve the above criteria for general application to all electric utilities in the State. HECO, however, believes that it is reasonable for HECO to have threshold criteria in determining when giveback discussions are appropriate. HECO claims that the criteria do not guarantee, or otherwise concede, that a giveback is appropriate; rather, they simply set forth the circumstances under which HECO believes continued discussions concerning the possibility of a giveback are warranted. In addition, HECO affirms that any givebacks negotiated would be, when appropriate, subject to the approval of the commission both as to the givebacks, and as to the underlying project to which the givebacks are attached.

3.

Community Benefits Package

As a result of the community meetings, the Community Group agreed to a set of six community benefits to comprise a Community Benefits Package that would be linked to HECO's application to build the CIP Generating Station Project. HECO stated that the Community Group believed that the proposed six community benefits were appropriate under the circumstances, and that they would mitigate the impact of the CIP Generating Station Project.

The Community Benefits Package consists of:

(1) A rate reduction for the immediately impacted area, or the "Residential Rate Reduction Program;"

(2) Construction of water facilities to substitute RO water from the BWS' Honouliuli Water Recycling Facility ("HWRF") for potable water presently being used at the Kahe Power Plant, or the "RO Water Pipeline Project;"

(3) The addition of three air monitoring stations and the resumption of the fish monitoring studies that HECO formerly conducted, or the "Environmental Monitoring Programs;"

(4) A long-term financial commitment from HECO to support conservation education to be spearheaded by leaders in the community ("Conservation Education Program");

(5) A "report card" on HECO's activities and distribution of the Campbell Local Emergency Action Network ("CLEAN") reports to the surrounding communities ("Community Report Card"); and

(6) A reaffirmation of HECO's corporate commitment to provide strong charitable support for activities in the West Oahu, or Waianae Coast communities ("Corporate Support Program").[16]

HECO only requests approval (and cost recovery through rates) for the first three of the six items proposed in the Community Benefits Package: (1) RO Water Pipeline Project; (2) Environmental Monitoring Programs; and (3) Residential Rate

[16]See Application at 11.

Reduction Program. HECO represents that the Conservation Education Program, Community Report Card, and Corporate Support Program, which collectively amount to over $1,000,000, will be sponsored by HECO's current operations or shareholders, and not by any additional ratepayer funds.[17]

HECO states that the net present value of annual revenue requirements for the Community Benefits Package, using an 8.58% discount rate, is approximately $10.9 million at present rates.[18] The potential incremental bill increase for the average residential customer is approximately $0.19 per month, while the average residential customer who receives the residential rate discount will see about a $0.18 per month increase.[19] Thus, HECO states that the total cost of the Community Benefits Package will be shared by HECO's customers, BWS (upon dedication of the RO Water Pipeline to BWS), and by HECO's current operations or shareholders.

Overall, HECO believes that the proposed Community Benefits Package is reasonable and an essential element of successfully siting the CIP Generating Station Project. Each of the first three items of the Community Benefits Package, which

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[17]The details and scope of the Conservation Education Program, Community Report Card, and Corporate Support Program are described in Exhibit D to the Application.

[18]See HECO RT-7 at 3; see also HECO-R-701.

[19]See HECO RT-7 at 3; see also HECO-R-704.

are the subject of the Application, are described in more detail below.

a.

RO Water Pipeline Project

HECO explained that the issue of potable water usage at the Kahe Power Plant arose as one possible giveback during the community meetings. HECO agreed, subject to commission approval, to reduce its potable water consumption at the Kahe Power Plant by using RO water produced by BWS using treated effluent from the HWRF.

Currently, the Kahe Power Plant uses about 210,000 gallons per day ("gpd") of BWS' potable water for industrial (151,000 gpd) and domestic (59,000 gpd) purposes.[20] HECO represents that the use of RO water at the Kahe Power Plant will reduce, on average, the potable water consumption from BWS for industrial purposes from approximately 151,000 gpd to about 11,000 gpd, or in other words, will reduce industrial potable water consumption by 140,000 gpd, or by 93%.[21] HECO asserts that the RO Water Pipeline Project benefits the community because it reduces HECO's potable water consumption at the Kahe Power Plant

[20]See HECO's O.B. at 18 n.11; HECO T-3 at 1.

[21]See HECO's O.B. at 18; HECO T-3 at 2.

by approximately 140,000 gpd on average, and allows this potable water to be available for other uses; moreover, the use of RO water recycles water that would otherwise be discharged to the ocean if not reclaimed by BWS from the HWRF.[22]

Specifically, the RO Water Pipeline Project involves the construction of a new pipeline from the CIP area to the Kahe Power Plant to deliver RO water from the HWRF. The new RO water pipeline will be approximately four miles long and will connect to an existing fourteen-inch BWS RO water pipeline at the west end of Roosevelt Avenue just east of Kalaeloa Boulevard. From the west end of Roosevelt Avenue, the RO water pipeline will be routed to the former Oahu Rail and Land Company ("OR&L") Right-of-Way to the Kahe Power Plant area, and will be connected to the existing Kahe Raw Water system[23] piping that feeds the Kahe demineralizer plant.[24]

The major components of the Kahe RO Water Pipeline Project include a four mile pipeline, a valve station, BWS

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[22]See HECO T-3 at 2.

[23]The raw water system refers to the untreated water used in the power plant. See HECO T-3 at 3.

[24]See Exhibit F to the Application. HECO states that it evaluated an alternative alignment for the pipeline along Farrington Highway to the Kahe Power Plant, but determined that the Farrington Highway alignment would have greater impacts on traffic and the community during construction compared to the OR&L alignment. For these reasons, HECO decided that the OR&L alignment is the preferred alignment. See HECO T-3 at 4-5.

pumping and pipeline delivery system modifications, filters, and a tank. The new Kahe RO water pipeline would be approximately six inches in diameter and constructed out of High Density Polethylene plastic, or another BWS approved pipe material. Several permits will likely be required for the new RO Water Pipeline Project, but HECO does not anticipate any significant obstacles in obtaining these permits.[25]

The estimated completion date for the RO Water Pipeline Project is July 2009. HECO targeted completion of the project to coincide with the date that the new CIP generating unit is scheduled to become operational. HECO states that this was done since the intent of the Kahe RO Water Pipeline Project is to minimize the use of potable water to reduce the overall environmental impact of the Kahe Power Plant, as a part of the Community Benefits Package related to the proposed CIP Generating Station Project.[26]

Once the RO water pipeline is completed, HECO plans to dedicate to the BWS the section of the RO water pipeline from the connection at the west end of Roosevelt Avenue up to the BWS meter located within the Kahe Power Plant ("RO Pipeline Section"). HECO explains that because it does not currently own,

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[25]The permits that will likely be required for the RO Water Pipeline Project are listed in HECO T-3 at 5-6.

[26]See HECO's O.B. at 19-20.

operate, or maintain water pipelines outside of its power plants, it makes sense for BWS to own, operate, and maintain the RO Pipeline Section. HECO has had initial discussions with BWS, and anticipates that BWS will agree to take over the ownership, operations, and maintenance of the RO Pipeline Section. In addition, HECO anticipates entering into an agreement with BWS for an adequate supply of RO water while retaining HECO's existing potable water allocations to serve as a backup to the RO water pipeline and RO water allocation.[27]

The RO Water Pipeline Project is estimated to cost $7.4 million.[28] HECO proposes to accumulate the costs related to design and construction of the RO Water Pipeline Project in Construction Work in Progress ("CWIP"). During the time project related costs are classified as CWIP, an Allowance for Funds Used During Construction ("AFUDC"), which represents the cost to finance the project during the construction period, will be applied on the project costs. At the time the RO water pipeline is declared used or useful, the costs would then be transferred to Plant in Service. HECO states that this accounting practice is consistent with any other capital expenditure project constructed in the normal course of HECO's business.[29]

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[27]See HECO T-3 at 10-11.

[28]See id. at 7; HECO-303.

[29]See HECO T-6 at 2.

Upon completion of the RO Water Pipeline Project, while HECO owns the RO water pipeline, HECO will include the costs in Plant in Service and begin depreciating the pipeline over the estimated useful life, beginning the start of the year following the year the pipeline is included in Plant in Service, consistent with other capital projects. When HECO dedicates the RO Pipeline Section to BWS, HECO proposes to reduce the Plant in Service balance for 84.5% of the cost of the RO Water Pipeline Project, which represents the portion of the RO water pipeline that would be dedicated to BWS, and charge a miscellaneous deferred debit account (a regulatory asset).[30]

HECO proposes to amortize the amount in the deferred debit account (a regulatory asset) over the estimated life of the RO water pipeline, currently estimated at fifty years, beginning the month following the dedication of the RO Pipeline Section to BWS. HECO proposes to include the amortization expense in revenue requirements when there is a rate case, and the unamortized miscellaneous deferred debit balance (a regulatory

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[30]The portion of the RO water pipeline retained by HECO would remain in Plant in Service. HECO maintains that, in the unlikely event that HECO and BWS are unable to reach an agreement regarding the transfer of ownership, operations, and maintenance of the RO Pipeline Section, HECO would maintain the RO Pipeline Section and the rest of the RO Water Pipeline Project and coordinate operations with BWS. See HECO T-3 at 11. Under this scenario, the RO water pipeline would remain in HECO's Plant in Service account, and the cost would be depreciated over the estimated useful life of the RO water pipeline. See HECO T-6 at 4.

asset) would be included in rate base in determining HECO's revenue requirements.

HECO explains that, if the RO Pipeline Section is dedicated to BWS, the related costs should not continue to be included as Plant in Service; however, because ratepayers continue to benefit from the RO water pipeline, the cost of the RO Pipeline Section dedicated to BWS should continue to be recovered from ratepayers through rates. HECO suggests that the effect of HECO's proposal mirrors the ratemaking impact if the RO Pipeline Section continued to be reflected as Plant in Service. HECO states: "Including the amortization expense in revenue requirements would be similar to including depreciation expense in determining revenue requirements. Likewise, including the unamortized balance in rate base, would be similar to including the undepreciated plant in service balance in rate base."[31]

In order for HECO to maintain the charges in a miscellaneous deferred debit account (a regulatory asset), HECO contends that it needs the commission to approve its proposed accounting treatment, which provides assurance that the rates in the future will reflect the amortization expense for the deferred cost, and the unamortized deferred costs would be included in rate base. In addition, HECO maintains that, if the commission

[31]HECO T-6 at 3.

does not approve HECO's proposed accounting and ratemaking treatment for the RO Pipeline Section upon its dedication to BWS, HECO would need to charge the cost of the RO Pipeline Section to an expense upon its dedication.

b.

Environmental Monitoring Programs

HECO proposes to implement two environmental monitoring programs as givebacks relating to the CIP Generating Station Project: (i) an air quality monitoring program; and (ii) the reinstatement of a fish monitoring program that HECO last conducted in the 1980s. HECO asserts that the goal of these programs is to provide an ongoing environmental profile of the area, including air and water quality, impacts on fish communities, and impacts on areas where food and medicinal plants are gathered. HECO intends to initiate the Environmental Monitoring Programs no later than approximately one year prior to the in-service date of the CIP Generating Station Project in order to establish baselines on the current conditions in the area. The air quality monitoring program and the fish monitoring program are described in further detail below.

(i)

Air Quality Monitoring Program

HECO proposes to construct and install three air quality monitoring stations ("AQM") in the general vicinity of HECO's CIP Generating Station Project. Based on input provided by the community, the preferred locations for the three AQMs have been identified as: (1) the CIP area, preferably makai of the HECO CIP generation site; (2) the Nanakuli area; and (3) the Waianae area.[32] Each AQM will continuously measure air quality data from all sources in the area that will include transportation, construction, and industrial sources, including the CIP Generating Station Project. The AQMs will be configured to measure criteria pollutants such as nitrogen dioxide, sulfur dioxide, carbon monoxide, ozone, and particulate matter. The instruments will be controlled remotely from HECO's Environmental Laboratory at the Waiau Generating Station.

As mentioned above, the three AQMs are proposed to begin collecting data approximately one year prior to the estimated July 2009 startup of the new combustion turbine generator at CIP to establish a baseline to compare the data after the start of the new combustion turbine. The three stations are expected to continue to operate and collect

[32]See HECO T-4 at 2.

data after the construction of the new generating unit, until otherwise determined. HECO proposes to work with the community to determine an acceptable format and interval for reporting the data being collected from the three AQMs.[33]

The equipment cost of an AQM and the costs associated with obtaining required permits and approvals (right-of-entry), security fencing, electric and telephone service drops, and grading or leveling (assuming simple access and minimal approvals are required) is approximately $190,000 per station.[34] Operations and maintenance expenses for data collection, audit, and support services are estimated at $120,000 annually per station.[35] More remote sites or sites with unique challenges may require additional costs to prepare. In sum, the estimated total cost for three stations is approximately $570,000 for equipment, site access and preparation, and annual operations and maintenance costs of $360,000.[36]

For the accounting treatment of the air quality monitoring program, HECO proposes to accumulate the costs related to site selection, site acquisition and permitting, and design and construction of the AQMs in CWIP. During the time project

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[33]See id. at 4.

[34]See Application at 18; see also HECO-403.

[35]See id.

[36]See Application at 18; HECO T-4 at 4.

related costs are classified as CWIP, an AFUDC will be applied on the project costs. At the time the AQM is declared used or useful, the costs would then be transferred to Plant in Service. HECO states that this accounting treatment is consistent with any other capital expenditure project constructed in the normal course of business.[37] The monitoring station would then be depreciated over the estimated service life of the equipment in the normal course of business. Depreciation expense would be included in revenue requirements, and the undepreciated cost would be included in rate base in a rate making proceeding.

HECO originally proposed to record the baseline monitoring costs in a deferred debit account, amortize the costs over ten years, and include the unamortized costs in HECO's rate base for ratemaking purposes. HECO proposed to expense air quality monitoring costs from the commercial operation date of the CIP generating unit through the duration of the program. The Consumer Advocate, however, opposed the regulatory deferred accounting treatment for the baseline monitoring costs, and instead, proposed that HECO follow normal National Association of Regulatory Utility Commissioners ("NARUC") accounting procedures for such costs. As discussed further below, HECO states that, in order to limit the issues in this proceeding, HECO is not seeking

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[37]See HECO T-6 at 8.

approval for deferred accounting treatment for the baseline monitoring costs for the air quality monitoring program.[38] These baseline monitoring costs will be expensed as incurred. HECO states that the Consumer Advocate did not comment on the accounting and ratemaking treatment of the air monitoring equipment, but that the accounting for those costs is the normal accounting for such equipment and is consistent with NARUC accounting practices.[39]

(ii)

Fish Monitoring Program

HECO proposes to reinstitute a fish monitoring program that was last conducted in the 1980s off the near shore waters of Kahe Power Plant. The fish monitoring program consists of scientists (e.g., marine biologists) conducting fish counts on established underwater transects to record the number, type, abundance, and distribution of fish. These transects will be located in the near shore waters fronting the CIP Generating Station (i.e., the CIP/Barbers Point area), and at the same fish monitoring stations used by HECO in its former fish monitoring program. In addition, six new fish monitoring transects or stations will be established in the CIP/Barbers Point area.

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[38]See HECO RT-6 at 6; Joint Stipulation at 4.

[39]See HECO RT-6 at 6.

HECO explains that a fish transect is a method of counting fish that is used by a researcher to investigate fish community structure in different reef habitats. HECO maintains that the collected data, including information on fish diversity abundance, and distribution, can be used to evaluate the health of reef fish communities and provide a source of data that can be used to update the existing Kahe and Barbers Point/CIP databases for current and future research. In addition, the collected data could provide observations about potential changes in the near shore reef fish communities or fish conditions, and the ecological condition of the reef as a whole in these areas.[40]

Like the air quality monitoring program, HECO intends to commence the fish monitoring program at least one year prior to the projected commercial operation date of the CIP generating station to establish a baseline database. HECO states that fish monitoring will be conducted quarterly, until such time that sufficient data is available to justify reduced monitoring frequencies or a reduction in the number of monitoring stations. HECO further states that the fish monitoring program will continue after the startup of the CIP generating station, until otherwise determined.[41]

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[40]See HECO T-5 at 2.

[41]See id. at 5.

The estimated cost of the fish monitoring program is $28,500 per year, once a full monitoring schedule is implemented in 2008.[42] During late 2007, there will also be an estimated project startup cost of $9,000 to establish the monitoring stations for the commencement of monitoring in 2008.[43] HECO now proposes to expense startup costs and fish monitoring costs as incurred, and it intends to include such costs in determining its revenue requirement in a rate case.[44]

c.

Residential Rate Reduction Program

The proposed Residential Rate Reduction Program would provide HECO's residential ratepayers with a service address located in zip code 96707 a discount on their base charges. The current rate schedules for which the discount will be applicable

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[42]See HECO's response to CA-IR-48.

[43]See HECO T-5 at 5-6.

[44]See HECO RT-6 at 3-4. Similar to the air quality monitoring program, HECO originally proposed to record the startup and baseline monitoring costs in a deferred debit account, amortize the costs over ten years, and include the unamortized costs, net of taxes, in HECO's rate base for ratemaking purposes. However, upon objection by the Consumer Advocate, in order to limit the issues in this proceeding, HECO states that it will not seek approval for deferred accounting treatment for the startup and baseline monitoring costs for the fish monitoring program; instead, such startup and baseline monitoring costs will be expensed as incurred. See id. at 4; Joint Stipulation at 4.

are Schedule R and Schedule E.[45] HECO, however, states that the discount will apply to all available residential rate schedules at the time the discount is put into rates.[46]

HECO originally estimated a seven percent discount for the Residential Rate Reduction Program, but it has since revised the program, and now proposes to cap the rate reduction at approximately $6 million total for the ten-year program, or approximately $600,000 on an annual basis.[47] In other words, the Residential Rate Reduction Program will use a percentage that results in an aggregate rate reduction total of $600,000 a year for ten years for HECO's customers in the 96707 zip code. To discourage wasteful use of energy, HECO will only apply the discount to the first 786 kWh (which is the current average use in the area) of individual use per month. Energy use over 786 kWh per month will not be discounted.[48]

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[45]The base elements of the residential bill are the Customer Charge, the Base Fuel Energy Charge, and the Non-Fuel Energy Charge for Schedule R and Schedule E. The residential rate reduction will apply to the Customer Charge and to the charge for the first 786 kilowatt hours ("kWh") of energy usage, as discussed below. The residential rate reduction will not apply to the Energy Cost Adjustment, the IRP Cost Recovery Adjustment, Residential DSM Adjustment, Rate Adjustment, or any other adjustment to base rates that may be in effect. See HECO T-2 at 3.

[46]See Tr. at 141:16-18.

[47]See HECO RT-1 at 12.

[48]See HECO T-1 at 24.

HECO seeks to implement the proposed Residential Rate Reduction Program as soon as possible after the in-service date of the CIP Generating Station Project, and continue the program for a period of ten years. HECO intends to implement the discount at the appropriate time using a thirty day tariff filing or short notice filing. HECO's billing program will be instructed to identify residential accounts with service addresses in zip code 96707 and to apply the discount to these accounts only.[49]

HECO stated that the Residential Rate Reduction Program arose during discussions of givebacks with the Community Group. The Community Group's consensus was that those in the immediate vicinity of a new facility, which benefits the entire community, should be recognized by the entire community for taking on that burden. For this reason, the Community Group specifically rejected the idea of HECO's shareholders paying for the discount; instead, the Community Group believed that the rest of the ratepayers on Oahu should pay for the discount. HECO further explained the rationale and sentiments of the Community Group

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[49]HECO explained that the discount will be applied only to residential customers because the CIP generating station is a peaking unit designed to operate between 5:00 and 9:00 p.m., so the Community Group preferred to limit the discount to residential ratepayers who would still be in the area when the plant was operating. See Tr. at 21:3-7.

relative to the development of the Residential Rate Reduction Program:

> During the meetings on givebacks, we came to a portion where ideas were put forth to consider. The Makakilo/Kapolei/Honokai Hale representatives were very clear that the giveback they wanted was a rate discount.
>
> We then had some discussion about the lack of precedent in Hawai`i for such a discount . . . . The discussion, therefore, assumed that rate discount proposals would be ground breaking and that proximity would be a critical factor.
>
> Still, the Makakilo/Kapolei/Honokai Hale group wanted to pursue rate discounts. From their point of view, which we understand, appreciate, and support, they are accepting a burden on behalf of the rest of Oahu. A rate discount has a great deal of symmetry in that regard.
>
> The amount of the discount is then picked up by all of the ratepayers on Oahu, people who do not have the power plant in their back yard. From their point of view, this transfer, if you will, is a just acknowledgment of what this neighborhood is doing on behalf of the rest of Oahu.
>
> The issue, by the way, of HEI shareholders paying was, in fact, raised and rejected specifically by the community because it missed that point and would, in fact, defeat the whole purpose of this giveback. The crucial point for the community is that the rest of Oahu, unburdened by the siting of the plant, should accept the burden of covering the discount given to those folks accepting the plant.[50]

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[50]Tr. at 19:4-25 - 20:1-15.

HECO made it clear that the Residential Rate Reduction Program (and in fact, all of the six proposed givebacks in the Community Benefits Package) originated from the Community Group. HECO explained:

> HECO did not present or choose any of the proposed givebacks. Therefore, HECO did not "consider" what should be the appropriate discount rate or the appropriate area for the discount rate. HECO simply researched and provided various discount rate scenarios, . . . and it was the Community Group that decided for themselves the appropriate rate discount and geographic area.[51]

As to the selection of the 96707 discount area, HECO further explained that even West Oahu communities outside of the 96707 zip code -- essentially, all the Waianae Coast communities from Nanakuli to Makaha -- were represented at the community meetings.[52] These communities, however, agreed that only those communities comprising the 96707 zip code should receive the rate discount.[53] According to HECO, "[f]rom the [C]ommunity Group's perspective, the Waianae area (zip code 96792) is not immediately proximate to the CIP station like the communities that immediately surround it, which was felt to be essential to making the case for a rate discount. Therefore, it was excluded from

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[51]HECO's Response to CA-IR-35.

[52]See HECO's Response to CA-IR-25.

[53]See id. A map provided by HECO in response to CA-IR-40 shows the communities comprising the 96707 zip code and their proximity to the CIP Generating Station Project.

the rate discounts."[54] HECO also explained that the 96707 zip code was chosen because it represented the CLEAN area. As a part of the CLEAN program,[55] the communities located in the 96707 zip code area are, among other things, notified by siren if there is a chemical discharge in the CIP area.[56]

B.

Stipulated Issues

Pursuant to Stipulated Prehearing Order No. 22382, the issues in this proceeding are:

1. Whether the proposed RO Water Pipeline Project, in accordance with Paragraph 2.3.g.2 of G.O. No. 7, will provide facilities that are reasonably required to meet HECO's present or future requirements for utility purposes?

2. Whether HECO's dedication of the RO water pipeline to BWS, in accordance with HAR § 6-61-105, HRS § 269-19, and Condition #13 of the HEI Conditions of Merger, is reasonable and in the public interest?

3. Whether HECO's proposed accounting and ratemaking treatments for the costs associated with the RO Water Pipeline Project are reasonable?

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[54] Id.

[55] CLEAN, which stands for Campbell Local Emergency Action Network, is a nonprofit organization that was "formed to bring together businesses, emergency responders and community members to facilitate emergency preparedness and response in [CIP]." HECO-104 at 21.

[56] See Tr. at 20:23-25.

4. Whether HECO's commitment of funds for the proposed Environmental Monitoring Program (Air Monitoring Programs and Fish Monitoring Program), in accordance with Paragraph 2.3.g.2 of G.O. No. 7, will provide facilities that are reasonably required to meet HECO's present or future requirements for utility purposes?

5. Whether HECO's proposed accounting and ratemaking treatments for the costs associated with the Environmental Monitoring Program are reasonable?

6. Whether the proposed Residential Rate Reduction Program and implementation in accordance with HAR §§ 6-61-86 and 6-61-110 are just and reasonable?[57]

C.

Joint Stipulation

On April 12, 2006, HECO filed its written direct testimonies and exhibits in support of the Application. After issuing discovery, to which HECO responded, the Consumer Advocate filed its written direct testimony, exhibits, and workpapers, setting forth its recommendation on each of the elements of the Community Benefits Package, on August 10, 2006.

On November 20, 2006, the commission convened a prehearing conference to discuss the evidentiary hearing that was scheduled to commence on November 29, 2006. On November 21,

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[57]See Stipulated Prehearing Order No. 22382, filed on April 12, 2006, at 3-4.

2006, the commission issued an order memorializing the discussions during the prehearing conference.

On November 22, 2006, HECO and the Consumer Advocate filed the Joint Stipulation wherein both Parties agreed to compromise and settle all of the issues and matters in this docket, except for the issue of whether rate recovery of foregone revenues arising from the Residential Rate Reduction Program and its implementation, in accordance with HAR §§ 6-61-86 and 6-61-110, are just and reasonable.[58]

The Parties specifically agreed as follows:

1. HECO should be allowed to commit funds for the construction and installation of the proposed RO Water Pipeline Project in accordance with Paragraph 2.3.g.2 of G.O. No. 7, as the RO Water Pipeline Project will provide facilities that are reasonably required to meet HECO's present or future requirements for utility purposes.

2. HECO should be allowed to dedicate a section of the RO Water Pipeline to BWS, in accordance with HAR § 6-61-105, HRS § 269-19, and Condition #13 of the Hawaiian Electric Industries Conditions of Merger, as such dedication is reasonable and in the public interest.

3. The proposed accounting and ratemaking treatments for the costs associated with the RO Water Pipeline Project as outlined in this docket are reasonable.

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[58]See Joint Stipulation at 4.

4. HECO should be allowed to commit funds for the proposed Environmental Monitoring Programs (Air Monitoring Program and Fish Monitoring Program), in accordance with Paragraph 2.3.g.2 of G.O. No. 7, as the Environmental Monitoring Programs will provide facilities that are reasonably required to meet HECO's present or future requirements for utility purposes.

5. HECO's proposed deferral accounting and regulatory asset treatment of startup and baseline monitoring costs for air and fish monitoring is withdrawn, as described in the rebuttal testimony of HECO witness Patsy Nanbu (HECO RT-6).[59]

By letter dated November 27, 2006, the commission informed the Parties that it was not inclined to rule on the Joint Stipulation prior to the evidentiary hearing, and instead, would take the Joint Stipulation under advisement.

On November 29, 2006, the commission held an evidentiary hearing at the commission's hearing room.

D.

Residential Rate Reduction Program

The Consumer Advocate recommended in its written direct testimony that the commission defer deciding on whether HECO should be allowed to implement the Residential Rate Reduction Program and recover the foregone revenues associated with the program from HECO's ratepayers until HECO seeks to implement the

[59]See id. at 3-4.

discount, which is likely to be in mid-2009 when the CIP Generating Station Project is expected to be in commercial operation. In the alternative, if the commission decides to make a determination on the Residential Rate Reduction Program at this time, the Consumer Advocate recommended that the commission allow HECO to offer the discount, but require HECO's shareholders, not its ratepayers, to pay for the foregone revenues associated with the rate discounts.

In response to the Consumer Advocate's recommendation, HECO stated that it does not intend to offer, and the communities do not want, a rate discount at HECO's shareholders' expense because the "community group has made it clear that it wants the rest of Oahu to pay for the rate reduction."[60] Based on that position, the Consumer Advocate contends that the implementation of the proposed rate discount, with HECO's ratepayers bearing responsibility for the foregone revenues associated with the discount, should not be authorized by the commission. The Consumer Advocate's several arguments in support of its position are addressed, in turn, below.

First, the Consumer Advocate argues that the proposed rate discount is arbitrary. The Consumer Advocate's consultant, Michael L. Brosch, testified in his direct testimony regarding the alleged arbitrary nature of the proposed discount:

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[60]HECO RT-1 at 11.

The proposed discounts are targeted to only a few communities. This is the only element of the [Community Benefits Package] that is not broadly beneficial to all West Oahu communities. By restricting the discounts to only residential customers in zip code 96707, the residents of the Waianae coast west of Kahe Point do not participate in this element of the [Community Benefits Package] even though they may perceive themselves to also be impacted by the new plant.

. . .

There are no residential customers immediately proximate to the new facilities because there are no residences located within Campbell Industrial Park, which is an area that is zoned for intensive industrial uses. In CA-IR-40, page 2, a map showing the location of the CIP Generating Station site in relation to the communities within zip code 96707 reveals that these communities are approximately two miles or further away from the site of the new facility. The proposed restriction of rate discount eligibility to **only** residents living within zip code 96707 appears to be entirely arbitrary and designed to simultaneously achieve an electric bill impact that is noticeable to the designated eligible customers, while not negatively impacting overall utility revenues so severely as to be objectionable to the Commission and jeopardize rate recovery.

. . .

The detailed terms of the rate discount proposal were determined through an arbitrary judgment process. HECO provided the community leaders with calculations indicating the revenue impact of multiple rate discount scenarios, including discounts at 1%, 2%, 5%, 7% and 10%, applying such percentages to "all customers" or to "residential" or "commercial" customers, and also illustrating different geographic

> scoping alternatives involving zip codes 96707 (Kapolei), 96706 (Ewa Beach) and 96792 (Waianae). Then, according to HECO, "it was the Community Group that decided for themselves the appropriate rate discount and geographic area." It appears that the proposed rate discount terms contained in the [Community Benefits Package] are the result [sic] the judgment of these community representatives regarding revenue burdens the Commission might accept in relation to customer impact targets that were deemed desirable by them. As noted previously, there is no apparent linkage between the arbitrarily determined terms of the proposed rate discount and the scope of alleged burdens caused by the Campbell Generating Facilities.[61]

Second, the Consumer Advocate argues that there are no significant burdens associated with the siting of the CIP Generating Station Project and related facilities in CIP for which compensation is warranted. The Consumer Advocate cites to testimony submitted by HECO in Docket No. 05-0145 (CIP Generating Station Project), wherein HECO stated that the CIP Generating Station Project is properly sited within an established industrial park that is already zoned for heavy industrial use, where the new CIP unit is expected to have only a modest impact on the environment or any immediate neighbors.[62] The Consumer Advocate also cites HECO's discovery responses to

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[61]CA-T-1 at 55-58 (emphases in original) (footnote omitted).

[62]The Consumer Advocate cites to HECO T-10, submitted in Docket No. 05-0145 (Testimony of Perry J. White), at 3-4; and HECO-1001, submitted in Docket No. 05-0145 (Summary of the Draft EIS prepared for the CIP Generating Station Project).

CA-IR-22 to suggest that, neither HECO nor the Community Group expect the CIP generating station to negatively affect the surrounding environment, the health of the community, real estate values, or aesthetics in any significant way. Thus, the Consumer Advocate concludes that no compensation has been shown to be required to address any identified burden resulting from the siting of the CIP Generating Station Project and related facilities in the CIP, since there is expected to be minimal impact from such siting.[63]

Third, the Consumer Advocate argues that additional compensation to avoid challenges to the permitting for the siting of the proposed CIP Generating Station Project in CIP is not required because the facilities are to be sited in an area appropriately zoned for industrial use. In this regard, the Consumer Advocate asserts that HECO's examples of recent siting challenges it has faced (i.e., Wa`ahila Ridge transmission line project and HELCO's Keahole generating station expansion project) are distinguishable from the CIP Generating Station Project because the CIP unit will be sited in an area that is appropriately zoned for industrial use, is not expected to cause negative impacts upon the community, and is located near fuel

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[63]See Consumer Advocate's Opening Brief, filed on January 8, 2007 ("Consumer Advocate's O.B.") at 15.

storage facilities, transmission lines, and electrical substations. The Consumer Advocate states:

> The Wa`ahila and Keahole projects faced opposition because they changed the character of the land proposed as the site for HECO's new infrastructure projects. The CIP Generating Station, by contrast, is qualitatively different from HECO's cited examples because the project is to be sited in an area where existing public policy tells citizens this is where a new generating facility should be located.[64]

Fourth, the Consumer Advocate argues that, unlike the other elements of the Community Benefits Package, the Residential Rate Reduction Program does not provide any benefit to address the concerns of the West Oahu community. The Consumer Advocate states that, with the exception of the proposed rate discounts, each element of the Community Benefits Package will create tangible benefits to ratepayers that bear some linkage to concerns caused by the construction of the new infrastructure in CIP, or that can be expected to produce benefits to HECO and its ratepayers commensurate with the costs involved to implement the Community Benefits Package elements. More particularly, Mr. Brosch testified:

> Rate discounts would do nothing to address the stated concerns of the communities regarding environmental testing/measurement, water conservation, energy conservation, renewable solar energy, distributed generation, health care, power lines along

[64] Id. at 16.

> Farrington Highway, beautification of Farrington Highway, or beach area recreational development. Ratepayer funded electricity discounts would do little more than satisfy a "make them pay" attitude apparently held by some residents who may believe it important as a matter of principal that there be cash compensation to area residents to compensate for burdens.[65]

Fifth, the Consumer Advocate argues that the Residential Rate Reduction Program is inconsistent with cost-based ratemaking. Citing HECO's testimony that the cost to serve residential customers in the same rate schedule is substantially the same regardless of zip code,[66] the Consumer Advocate contends that HECO has failed to provide any evidence to demonstrate the reasonableness of assessing a lower rate to residential customers receiving electric service in zip code 96707 from the rate charged other residential ratepayers receiving service in other parts of HECO's service territory. Thus, the Consumer Advocate recommended that:

> The Commission should not adopt any general policy favoring community benefit cash subsidy programs funded by utility ratepayers when the Company has not provided evidence to support the reasonableness of its request. Instead, the Commission should continue to practice cost-based ratemaking and not allow utility rates to be utilized as a vehicle to transfer cash resources among geographic,

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[65]CA-T-1 at 60 (footnotes omitted).

[66]See Tr. at 155:1-8.

cultural or socio-economic groups in an effort to achieve societal "equity."[67]

Sixth, the Consumer Advocate argues that the Residential Rate Reduction Program may be viewed as discriminatory against other ratepayers in the same customer class. In this regard, the Consumer Advocate contends that the Residential Rate Reduction Program treats residential ratepayers receiving service in one zip code (96707) differently from residential ratepayers receiving electric service in all other zip codes, in contravention of HRS § 269-16(b)(2)(B), which provides that the commission should "prohibit rebates and unreasonable discrimination between localities or between users or consumers under substantially similar conditions[.]" Moreover, the Consumer Advocate maintains that HECO has offered no evidence in support of any distinction in the cost, quality or character of utility service provided in zip code 96707 that would justify distinctly lower rates for customers in that area.

Seventh, the Consumer Advocate argues that HECO's proposed rate discount is unprecedented. The Consumer Advocate notes that even HECO acknowledges that the community benefits or givebacks process "is a relatively new concept here in Hawaii."[68] The Consumer Advocate also notes that, when asked in CA-IR-7

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[67]CA-T-1 at 32.

[68]HECO's response to CA-IR-16.

about its research into regulatory treatment of community benefits, HECO cited only a few cases in which rate discount benefits in any form were provided to local areas as part of approved local facilities; however, none of the cases cited by HECO included utility rate discounts to compensate residents for burdens associated with the siting of power plants.[69]

Eighth, the Consumer Advocate argues that the Residential Rate Reduction Program is contrary to commission policy and past precedent. Here, the Consumer Advocate cites three past decisions by the commission to suggest that the commission, for many years, has not relied on social policy imperatives as the basis for setting utility prices, and has chosen not to depart from its policy of cost-based regulation.[70]

Ninth, the Consumer Advocate argues that social policy ratemaking is a dangerous precedent that should be embarked upon carefully. Mr. Brosch explained:

> A dangerous precedent can be established when utility rates are used to effect remedies for actual or perceived social injustices. In my opinion, adoption of a regulatory policy to use utility rate discounts to remedy social concerns would unreasonably broaden the scope of future utility regulatory proceedings and likely frustrate the ability to process rate cases in a timely manner.[71]

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[69]See Consumer Advocate's O.B. at 26; CA-T-1 at 49-50 n.25.

[70]See Consumer Advocate's O.B. at 27-28 (discussing the commission's decisions in Docket Nos. 99-0207, 6789, and 7256.

[71]CA-T-1 at 53.

Moreover, regarding HECO's proposed criteria for determining when community benefits are appropriate, Mr. Brosch opined:

> Unfortunately, there is no assurance that other communities will conform in the future to the "criteria" that HECO advocates in its Application to restrict ratepayer-funded community subsidies to only certain narrow circumstances, even if the Commission embraces such criteria in this Docket. Additionally, some of the criteria require judgments regarding whether the facility is viewed as "critical to Hawaii's economy" or whether the "neighborhood already bears substantial burdens" for which no generally accepted metrics exist. There can be much dispute regarding the application of such judgmental criteria, thereby lengthening the time it takes to process future regulatory proceedings, which include rate cases. Therefore, I recommend that any future Applications for [Community Benefits Package]-like community subsidy programs be considered by the Commission on their merit, without applying any predetermined screening criteria and with the benefit of specific decisions reached and policies established in the instant Docket.[72]

II.

Findings and Conclusions

At the outset, the commission commends HECO and the Community Group for their efforts in trying to work together to resolve concerns relating to the siting of the CIP Generation

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[72] Id. at 54 (footnote omitted).

Station Project. The commission recognizes that this was a new approach taken by HECO. The commission appreciates the time, planning, and consideration that went into the process on behalf of all involved.

A.

Joint Stipulation

HECO seeks approval of the Application under G.O. No. 7, which states, in relevant part:

> Proposed capital expenditures for any single project related to plant replacement, expansion or modernization, in excess of [$2,500,000][73] or 10 per cent of the total plant in service, whichever is less, shall be submitted to the Commission for review at least 60 days prior to the commencement of construction or commitment for expenditure, whichever is earlier.[74]

HECO also seeks approval of the RO Water Pipeline Project under HRS § 269-19, which provides:

> No public utility corporation shall sell, lease, assign, mortgage, or otherwise dispose of or encumber the whole or any part of its road, line, plant, system, or other property necessary or useful in the performance of its duties to the public, or any franchise or permit, or any right thereunder, nor by any means, directly or indirectly, merge or

[73]In Docket No. 03-0257, the commission increased the monetary threshold governing the filing of capital expenditure applications, from $500,000 to $2.5 million, exclusive of customer contributions, effective July 1, 2004. See Decision and Order No. 21002, filed on May 27, 2004, in Docket No. 03-0257.

[74]G.O. No. 7, Paragraph 2.3.g.2.

> consolidate with any other public utility corporation without first having secured from the public utilities commission an order authorizing it so to do. Every such sale, lease, assignment, mortgage, disposition, encumbrance, merger, or consolidation, made other than in accordance with the order of the commission shall be void.[75]

As discussed above, by the Joint Stipulation, the Parties agreed that HECO's RO Water Pipeline Project and Environmental Monitoring Programs will provide facilities that are reasonably required to meet HECO's present or future requirements for utility purposes. Upon review of the entire record herein, the commission agrees with the Parties' stipulations and finds that both projects are reasonable and in the public interest, and accordingly, should be approved.

First, with respect to the RO Water Pipeline Project, as noted above, HECO represents that the use of RO water at the Kahe Power Plant, as contemplated by the project, will reduce, on average, HECO's industrial potable water consumption at the Kahe Power Plant from approximately 151,000 gpd to about 11,000 gpd, or by 93%. The commission finds that such a reduction will result in a significant savings of potable water that should

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[75]In addition, HECO seeks approval of the RO Water Pipeline Project under Condition #13 of the Hawaiian Electric Industries Conditions of Merger, which provides that HECO must seek prior commission approval before transferring any of its property that is or was in rate base, or assuming, directly or indirectly, any liabilities of Hawaiian Electric Industries. See Decision and Order No. 20882, filed on March 31, 2004, in Docket No. 04-0050.

benefit not only the communities surrounding the Kahe Power Plant, but the island as a whole. As noted by HECO, the RO Water Pipeline Project benefits the community because it reduces HECO's potable water consumption at the Kahe Power Plant by approximately 140,000 gpd on average, and allows this potable water to be available for other uses; moreover, the use of RO water recycles water that would otherwise be discharged to the ocean if not reclaimed by BWS. In addition, HECO expects to realize some annual savings in operations and maintenance costs by using RO water at the Kahe Power Plant.[76]

The commission recognizes that, from a cost perspective, the RO Water Pipeline Project may not be viewed as economically sound on a stand-alone basis.[77] However, given the significant island-wide conservation benefits associated with the project, and the specific advantages of the project to the Community Group as a negotiated component of the Community Benefits Package,[78] the commission finds, on balance, that the

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[76]Most of the savings arise from lower chemical and water costs to operate the Kahe demineralizer. See HECO's response to CA-IR-26c.

[77]The RO Water Pipeline Project is estimated to be relatively costly, at approximately $7.4 million, and the record indicates that HECO may obtain a discount for RO water from BWS, but it has not yet firmly negotiated the price for RO water with BWS. See also Tr. at 182:21-25 - 183:1-23.

[78]HECO stated that the Community Group "made a strong point that *wai*, fresh water, is of extraordinary cultural importance to Native Hawaiians." HECO's response to CA-IR-55. Thus, the

RO Water Pipeline Project is a reasonable expenditure that is consistent with the public interest. The commission further finds reasonable the proposed accounting and ratemaking treatment for the RO Water Pipeline Project, as set forth in the Joint Stipulation.

Second, as to HECO's Environmental Monitoring Programs, the commission finds that both the Air Quality Monitoring Program and the Fish Monitoring Program appear likely to provide a supplemental environmental profile of the area surrounding the CIP Generating Station Project.[79] The commission further finds that both programs are cost-effective measures that directly address the Community Group's concerns regarding the CIP Generating Station Project's impacts on the surrounding environment. Thus, the commission concludes that the Environmental Monitoring Programs are positive programs that should be approved. Likewise, the commission finds that the proposed accounting and ratemaking treatment for the Environmental Monitoring Programs, as proposed in the Joint Stipulation, are reasonable and should be approved.

RO Water Pipeline Project was included in the Community Benefits Package in order to reduce the environmental impact of the Kahe Power Plant by conserving potable water.

[79]According to HECO, the Environmental Monitoring Programs, requested by the Community Group, are meant to supplement the existing monitoring programs in the CIP area. See HECO's response to CA-IR-27.

The commission notes that it is approving the RO Water Pipeline Project and the Environmental Monitoring Programs based on the evidence presented in this docket only, and as detailed in the Joint Stipulation. The commission makes no ruling on the six threshold criteria proposed by HECO for determining when "giveback" discussions are appropriate. The commission will rule on other benefits-type projects, if appropriate, when brought before the commission.

B.

Residential Rate Reduction Program

As noted by the Parties, the Residential Rate Reduction Program is a matter of first impression for the commission,[80] and is also, fundamentally, a matter of public policy. Again, the commission appreciates the cooperative objectives of HECO and the Community Group during the community benefits process. However, the commission finds, based on a thorough review of the record before it, that unlike the RO Water Pipeline Project and the Environmental Monitoring Programs, there is insufficient evidence

[80]In fact, the proposed residential rate reduction is unprecedented in other jurisdictions. HECO was asked in discovery about its research into the regulatory treatment of community givebacks. As noted by the Consumer Advocate, none of the cases cited by HECO in its discovery responses involved utility rate discounts to compensate residents for burdens associated with the siting of power plants. See CA-T-1 at 50 n.25.

in the record to show that the ratepayer-funded discounts contemplated by the Residential Rate Reduction Program, would be reasonable, necessary, responsive to the stated concerns of the Community Group, or would result in just and reasonable rates. In this regard, the commission agrees with the Consumer Advocate's numerous arguments against the program.

In particular, the commission finds that the amount, duration, and geographic boundary of the discount, are arbitrary. HECO asserts that the terms of the discount were decided by the Community Group, based upon what the Community Group believed was fair. Although the commission recognizes the value of community-initiated proposals, the commission concurs with the Consumer Advocate's suggestion that utilities should nonetheless be held to a prudence standard when bringing to the commission community benefits-type proposals; moreover, utilities should still be required to demonstrate the reasonableness and cost-effectiveness of the proposals.[81] Here, the commission finds that, while the RO Water Pipeline Project and the Environmental Monitoring Programs satisfy those standards, HECO has not made a sufficient showing that the terms of the Residential Rate Reduction Program satisfy those standards.

Moreover, the commission finds that the record lacks evidence showing objective "burdens" placed on the communities

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[81]See Tr. at 185:25 - 186:1-8.

immediately surrounding the CIP Generating Station Project that would justify ratepayers on the rest of the island bearing the cost of the proposed discounts. As discussed in Docket No. 05-0145, the CIP Generating Station Project is properly sited in CIP, an established industrial park that is already zoned for heavy industrial use, where the new generating unit is not expected to have any significant impacts on the environment or on any immediate neighbors. Indeed, the record indicates that the Community Group was unable to identify any specific adverse impacts of the CIP Generating Station Project on the environment, health, real estate values, or aesthetics in the area.[82] The record also shows that the residential customers receiving service in the 96707 zip code are at least two miles away from the proposed location of the CIP Generating Station Project.[83] As such, the commission finds that there is no objective "burden" warranting ratepayer-funded discounts to the 96707 zip code.

Furthermore, as argued by the Consumer Advocate, the commission finds that the rate discounts contemplated by the Residential Rate Reduction Program are inconsistent with cost-based ratemaking. Under cost-based ratemaking principles, which have been traditionally adhered to by the commission,

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[82]See HECO's response to CA-IR-22.

[83]See map included with HECO's response to CA-IR-40; Tr. at 43:16-25 - 46:1-21.

utility rates are set based upon prudently incurred costs of providing safe and adequate service to customers. Here, the record demonstrates that there would be no difference in the cost of providing electric service to ratepayers within the 96707 zip code and to those residing outside of the 96707 zip code.[84] Moreover, HECO has not provided adequate evidence to demonstrate the reasonableness of its request to assess a lower rate to customers within the 96707 zip code, compared to the rate charged to residential customers living outside of that zip code. For all of these reasons, the commission determines that approval of the program would contravene traditional cost-based ratemaking. Further, the commission is unwilling to depart from past precedent absent evidence in the record demonstrating a reasonable justification to do so.

Relatedly, the commission finds that implementation of the Residential Rate Reduction Program may result in unreasonably discriminatory rates among ratepayers in the same customer class. Pursuant to HRS § 269-16(b)(2)(B), the commission is obligated to: "[p]rohibit rebates and unreasonable discrimination between localities or between users or consumers under substantially similar conditions[.]" As discussed above, the Residential Rate Reduction Program treats residential ratepayers receiving electric service in one zip code, i.e., 96707, differently from

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[84]See Tr. at 151:25 - 152:1-22, 153:24-25 - 154:1-25.

residential ratepayers receiving service in all other zip codes. Moreover, HECO has not offered sufficient evidence to support any distinction in the cost, quality, or character of utility service provided in zip code 96707 that would justify distinctly lower rates for customers in that area.

Overall, the commission determines that the social policy objectives of the Residential Rate Reduction Program, if approved, would not make sound regulatory policy, and instead, should be more appropriately addressed by the State Legislature.

Accordingly, for all of the reasons discussed above, the commission concludes that the Residential Rate Reduction Program should be denied.

III.

Orders

THE COMMISSION ORDERS:

1. HECO's request to commit funds for the purchase and installation of the RO Water Pipeline Project, and subsequent dedication to BWS, as described in the Joint Stipulation, is approved; provided that no part of the project may be included in HECO's rate base unless and until the project is in fact installed, and is used and useful for public utility purposes.

2. HECO's request to commit funds for the purchase and installation of the Environmental Monitoring Programs, as

described in the Joint Stipulation, is approved; provided that no part of the programs may be included in HECO's rate base unless and until the programs are in fact installed, and are used and useful for public utility purposes.

3. The proposed accounting and ratemaking treatments for the costs associated with the RO Water Pipeline Project and Environmental Monitoring Programs, as outlined in the Joint Stipulation, are approved.

4. HECO's request to commit funds for purposes of the proposed Residential Rate Reduction Program is denied.

5. HECO shall submit reports within sixty days of the commercial operation of the RO Water Pipeline Project and the Environmental Monitoring Programs, with an explanation of any deviation of ten percent or more in the costs of the RO Water Pipeline Project and the Environmental Monitoring Programs from those estimated in the Application. HECO's failure to submit these reports will constitute cause to limit the costs of the RO Water Pipeline Project and the Environmental Monitoring Programs, for ratemaking purposes, to those estimated in the Application.

6. HECO shall conform to the commission's orders set forth in paragraph 5, above. The failure to adhere to the commission's orders shall constitute cause for the commission to

void this Decision and Order, and may result in further regulatory action as authorized by law.

DONE at Honolulu, Hawaii JUN 27 2007.

PUBLIC UTILITIES COMMISSION
OF THE STATE OF HAWAII

By _____
Carlito P. Caliboso, Chairman

By _____
John E. Cole, Commissioner

APPROVED AS TO FORM:

_____
Kaiulani Kidani Shinsato
Commission Counsel

05-0146.sl

CERTIFICATE OF SERVICE

I hereby certify that I have on this date served a copy of the foregoing Decision and Order No. 23514 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: JUN 27 2007