BEFORE THE PUBLIC UTILITIES COMMISSION

OF THE STATE OF HAWAII

----In the Matter of----

PUBLIC UTILITIES COMMISSION

Instituting a Proceeding to
Investigate the Calculation of
Schedule Q Payment Rates

DOCKET NO. 2008-0069

ORDER NO. 24157

Filed april 18, 2008

At 1 o'clock P.M.

Karen Higashi

Chief Clerk of the Commission

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

K. Higashi

BEFORE THE PUBLIC UTILITIES COMMISSION

OF THE STATE OF HAWAII

----In the Matter of---- PUBLIC UTILITIES COMMISSION Instituting a Proceeding to Investigate the Calculation of Schedule Q Rates	Docket No. 2008-0069 Order No. 24157

ORDER

By this Order, the commission initiates an investigation to consider the methodology for calculating Schedule Q payment rates.

I.

Background

On August 3, 2007, Hawaii Electric Light Company, Inc. ("HELCO") filed an application in Docket No. 2007-0220 for commission approval to include in its Energy Cost Adjustment Clause ("ECAC") the costs of purchased energy under a Schedule Q purchased power contract ("Contract") with the County of Hawaii ("County"). Under the terms of the Contract, HELCO agreed to purchase energy made available by the County from a 50 kilowatt ("kW") hydroelectric plant owned and operated by the County at rates as will be determined by HELCO's Schedule Q.

By letter dated January 28, 2008, the commission requested that the parties to Docket No. 2007-0220 brief the issue of whether the Contract payment rates (which are based on

Schedule Q) comply with Act 162, Session Laws of Hawaii 2006 ("Act 162"). Act 162, which took effect on June 2, 2006, amended HRS § 269-27.2(c) by adding a third paragraph, such that subsection (c) now reads as follows:

> The rate payable by the public utility to the producer for the nonfossil fuel generated electricity supplied to the public utility shall be as agreed between the public utility and the supplier and as approved by the public utilities commission; provided that in the event the public utility and the supplier fail to reach an agreement for a rate, the rate shall be as prescribed by the public utilities commission according to the powers and procedures provided in this chapter.
>
> In the exercise of its authority to determine the just and reasonable rate for the nonfossil fuel generated electricity supplied to the public utility by the producer, the commission shall establish that the rate for purchase of electricity by a public utility shall not be more than one hundred per cent of the cost avoided by the utility when the utility purchases the electrical energy rather than producing the electrical energy.
>
> <u>The commission's determination of the just and reasonable rate shall be accomplished by establishing a methodology that removes or significantly reduces any linkage between the price of fossil fuels and the rate for the nonfossil fuel generated electricity to potentially enable utility customers to share in the benefits of fuel cost savings resulting from the use of nonfossil fuel generated electricity.</u> As the commission deems appropriate, the just and reasonable rate for nonfossil fuel generated electricity supplied to the public utility by the producer may include mechanisms for reasonable and appropriate incremental adjustments, such as adjustments linked to consumer price indices for inflation or other acceptable adjustment mechanisms.

HRS § 269-27.2(c) (emphasis added).

By letter dated and filed on March 7, 2008, which is attached to this Order, HELCO responded to the commission's January 28, 2008 letter stating that "the provision added by Act 162 concerning establishing a methodology to remove or reduce any linkages between the price of fossil fuels and the rate for nonfossil fuel generated electricity only comes into play where the utility and the supplier fail to reach agreement on a rate for purchase."[1] HELCO further stated that "[i]n recognition of the implications of the added language, the HECO Companies [i.e., HELCO, Hawaiian Electric Company, Inc. ("HECO") and Maui Electric Company, Ltd. ("MECO")] are willing to propose a new methodology to calculate Schedule Q payment rates which will result in fixed payment rates over the term of the Schedule Q contract (which the HECO Companies are proposing to extend to 5 years)" but that the "proposed new methodologies to compute Schedule Q payment rates should be examined in detail in a new Commission proceeding instead of this docket."[2]

With respect to the new methodologies for calculating Schedule Q payment rates, HELCO proposes:

> The avoided energy cost rates paid to Schedule Q producers could be fixed for a reasonable period (such as five years), but still be based on avoided energy costs as is required by PURPA, as well as by H.R.S. §269-27.2(c).
>
> In general, HELCO proposes that the revised methodology for determining Schedule Q payment rates for HELCO, HECO and Maui Division be similar to the methodology proposed in the Updated Stipulation to Resolve Proceeding

[1]Letter dated and filed March 7, 2008, in Docket No. 2007-0220, from HELCO to the commission, at 2.

[2]Id.

("Updated Stipulation") filed in Docket No. 7310 on December 29, 2006. The calculation methodology is briefly described on page 9 of the Updated Stipulation and would use the QF-in/QF-out method for HECO, HELCO, and Maui Division of MECO.

In the QF-in/QF-out method described in the Updated Stipulation, the production simulation to determine avoided fuel costs would be performed annually, and the resulting avoided fuel costs would be available October 1 of each year for each ensuing year. The updated fuel costs would be updated monthly for changes in fuel prices. Under this methodology, avoided fuel costs would <u>not</u> be delinked from the actual price of fossil fuel. Therefore, in order to delink Schedule Q rates from actual fossil fuel prices at the time the energy is purchased, HELCO proposes to use forecasted fuel prices when using the QF-in/QF-out method to determine Schedule Q rates. In addition, HELCO proposes to determine Schedule Q rates for a five-year forward-looking period using forecasted fuel prices. Once HELCO has agreed to purchase energy from a seller under Schedule Q rates, the rates of purchase would be fixed in the agreement according to this forward-looking price schedule. The rates would not change over the term of the agreement, even though actual fuel prices will change at the time the energy is purchased.

In general, with respect to Schedule Q payment rates for Lanai and Molokai, in order to eliminate the linkage between the price of fuel and the rates for purchase for Schedule Q contracts, MECO proposes that rates of purchase be determined using the proxy method for five year periods without any adjustment for actual fuel prices at the time the utility purchases the energy. To accomplish this, MECO proposes to use forecasted fuel prices when using the QF-in/QF-out method to determine Schedule Q rates. In addition, MECO proposes to determine Schedule Q rates for Molokai and Lanai using the proxy method for a five-year forward-looking period using forecasted fuel prices for the respective islands. Once MECO has agrees to purchase energy from a seller under Schedule Q rates, the rates of purchase would be fixed in the agreement according to this forward-looking price schedule. The rates would not change, even though actual fuel prices will change at the time the energy is purchased.

> The HECO Companies base their fuel price forecasts on a projection of world oil prices contained in the Energy Information Administration's ("EIA") Annual Energy Outlook ("AEO") publication. The EIA typically releases the final AEO forecast in the first quarter of each year. The HECO Companies would use the EIA's AEO to develop their fuel price forecasts using statistical correlations between the prices of the fuels used by the HECO Companies and world oil prices as recorded in the AEO. The HECO Companies' fuel price forecast would generally be available in the second quarter of the year. To provide sufficient time for the HECO Companies to perform the avoided energy cost calculations for the forward-looking five-year period, the HECO Companies propose that the Schedule Q rates be available November 1 of a particular year for an ensuing five-year period.[3]

By Decision and Order No. 24099, filed on March 20, 2008, in Docket No. 2007-0220, the commission approved HELCO's request to include the costs of purchased energy under its Schedule Q purchased power contract with the County in its ECAC, pursuant to Hawaii Administrative Rules ("HAR") § 6-60-6(2). In a footnote, however, the commission noted its disagreement with HELCO's assertion that "'the provision added by Act 162 concerning establishing a methodology to remove or reduce any linkages between the price of fossil fuels and the rate for nonfossil fuel generated electricity only comes into play where the utility and the supplier fail to reach agreement on a rate for purchase.'"[4] "Having participated in the legislative process associated with the passage of Act 162,

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[3]Id. at 3-6 (footnotes and text therein omitted) (emphasis in original).

[4]Decision and Order No. 24099, filed on March 20, 2008, in Docket No. 2007-0220, at 4 n.4.

it is the commission's interpretation that Act 162 requires the significant reduction or removal of the linkage between the price of fossil fuels and the purchase rate for nonfossil fuel generated electricity for all new purchased power contracts and agreements, including those instances where the utility enters into new Schedule Q purchased power contracts."[5]

The commission, however, agreed with HELCO's request to examine "a new methodology to calculate Schedule Q payment rates which will result in fixed payment rates over the term of the Schedule Q contract" in a new commission proceeding, and stated that it would "open a new docket to examine the methodology for calculating Schedule Q rates."[6]

II.

Discussion

A.

Investigation

HRS § 269-7 provides, in relevant part:

> (a) The public utilities commission and each commissioner shall have the power to examine the condition of each public utility, the manner in which it is operated with reference to the safety or accommodation of the public, the safety, working hours, and wages of its employees, the fares and rates charged by it, . . . and all matters of every nature affecting the relations and transactions between it and the public or persons or corporations.

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[5] Id.

[6] Id.

. . . .

> (c) Any investigation may be made by the commission on its own motion, and shall be made when requested by the public utility to be investigated, or by any person upon a sworn written complaint to the commission, setting forth any prima facie cause of complaint.

HRS § 269-7(a) and (c) (emphasis added).

Similarly, in HRS § 269-6, the commission is broadly vested with "general supervision . . . over all public utilities[.]" More particularly, under HRS § 269-16, the commission is authorized to regulate the rates, charges, and practices of a public utility:

> (a) All rates, fares, charges, classifications, schedules, rules, and practices made, charged, or observed by any public utility, or by two or more public utilities jointly, shall be just and reasonable and shall be filed with the public utilities commission . . . .
>
> (b) No rate, fare, charge, classification, schedule, rule, or practice, . . . shall be established, abandoned, modified, or departed from by any public utility, except after thirty days' notice as prescribed in section 269-12(b) to the commission and prior approval by the commission for any increases in rates, fares, or charges.

HRS § 269-16(a) and (b).

Commission investigatory authority is also set forth in HRS § 269-15 and HAR § 6-61-71.

B.

Named Parties

Since all regulated electric utilities in the State will likely be impacted by the outcome of this investigation, the commission names as parties to this proceeding, HECO, HELCO, MECO, and KAUAI ISLAND UTILITY COOPERATIVE ("KIUC"). The commission also names the DEPARTMENT OF COMMERCE AND CONSUMER AFFAIRS, DIVISION OF CONSUMER ADVOCACY ("Consumer Advocate") as the Consumer Advocate is statutorily mandated to represent, protect, and advance the interests of all consumers of utility service and is an ex officio party to any proceeding before the commission.[7] Their involvement and participation in this proceeding will assist the commission in developing a sound record for its investigation into the methodology for calculating Schedule Q payment rates.

In addition, the commission will provide a copy of this order to all individuals and entities that were involved in some manner in Docket No. 7310 related to avoided costs, as the commission anticipates that some of those same entities or individuals may want to intervene or participate in the instant proceeding.[8] If these entities are interested in participating in this proceeding, they may file a motion to intervene or to participate without intervention in accordance with the requirements of HAR Chapter 6-61, Subchapter 4.

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[7]See HRS § 269-51; HAR § 6-61-62. HECO, HELCO, MECO, KIUC and the Consumer Advocate are collectively referred to as the "Parties."

[8]The parties in Docket No. 7310 consisted of HECO, HELCO, MECO, the Consumer Advocate, Mauna Kea Power Company, Inc. ("MKPC"), the Hawaii Agriculture Research Center ("HARC"), and the Department of the Navy, on behalf of the Department of Defense ("DOD"). Thus, as a courtesy, the commission is providing copies of this order to MKPC, HARC, the DOD, and their respective counsel.

C.

Preliminary Issues

Through this docket, the commission intends to address the appropriate methodology for calculating Schedule Q payment rates, including the methodologies proposed by HELCO in its March 7, 2008 letter. Accordingly, the commission sets forth the following preliminary issues to be addressed in this proceeding:

(1) What is the appropriate methodology or methodologies for calculating Schedule Q payment rates given the applicable law, including HRS § 269-27.2(c), the Public Utilities Regulatory Policies Act of 1978, as amended, and Hawaii Administrative Rules Chapter 6-74.

(2) Whether the methodologies for calculating Schedule Q payment rates proposed by HELCO are reasonable and comply with all applicable laws.

(3) Whether a methodology other than the methodologies proposed by HELCO for calculating Schedule Q payment rates should be adopted by the commission, and, if so, is the methodology reasonable.

These are preliminary issues for consideration. During the development of the prehearing (or procedural) order for this proceeding, the parties (and intervenors and participants, if any) shall have the opportunity to restructure these preliminary issues, stipulate to eliminate them, or suggest other issues for resolution in this proceeding for the commission's review and consideration.

D.

Procedural Matters

Any interested individual, entity, agency, or community or business organization may file a timely motion to intervene or participate without intervention in this docket in compliance with the commission's rules set forth in HAR Chapter 6-61, Subchapter 4. Motions to intervene or participate without intervention must comply with all applicable rules of HAR Chapter 6-61, Subchapter 4 of the Rules of Practice and Procedure Before the Public Utilities Commission.

If a protective order to govern the treatment of certain documents is desired, the Parties (and intervenors and participants, if any) shall file a stipulated protective order for the commission's review and approval within forty-five (45) days from the date of this Order. If the Parties (and intervenors and participants, if any) are unable to stipulate, each party or participant shall file proposed protective orders for the commission's review and consideration within the forty-five (45)-day filing deadline.

Within forty-five (45) days of the date of this Order, the Parties (and intervenors and participants, if any) shall file a stipulated prehearing (or procedural) order to govern the matters of this investigation for the commission's review and approval. If the Parties (and intervenors and participants, if any) are unable to stipulate, each of them shall file proposed orders for the commission's review and consideration within the forty-five (45)-day filing deadline.

The commission expects all Parties (and intervenors and participants, if any) to this proceeding to participate fully in the development of the necessary procedures and issues for the orderly conduct of this investigatory proceeding, consistent with all applicable State laws and commission rules and regulations. Moreover, if necessary or appropriate, the Parties (and intervenors and participants, if any) to this proceeding will be expected to actively participate in an evidentiary hearing or other procedures authorized by State law.

III.

Orders

THE COMMISSION ORDERS:

1. An investigative proceeding is initiated to examine the methodology for calculating Schedule Q payment rates.

2. The commission designates HECO, HELCO, MECO, KIUC, and the Consumer Advocate as parties to this investigative proceeding.

3. Any individual, entity, organization, or agency desiring to intervene as a party or to participate without intervention in this proceeding shall file a motion to intervene or participate without intervention not later than

twenty (20) days from the date of this Order. Motions to intervene or participate without intervention must comply with all applicable rules of HAR Chapter 6-61, Rules of Practice and Procedure Before the Public Utilities Commission.

4. Within forty-five (45) days of the date of this Order, the parties (and intervenors and participants, if any) shall develop a stipulated protective order, if necessary, and a stipulated prehearing (or procedural) order to govern the matters of this investigation for the commission's review and approval. If the parties (and intervenors and participants, if any) are not able to stipulate, each of them shall file proposed orders for the commission's consideration by such date.

DONE at Honolulu, Hawaii APR 18 2008.

PUBLIC UTILITIES COMMISSION
OF THE STATE OF HAWAII

By Carlito P. Caliboso
Carlito P. Caliboso, Chairman

By John E. Cole
John E. Cole, Commissioner

By
Leslie H. Kondo, Commissioner

APPROVED AS TO FORM:

Stacey Kawasaki Djou
Commission Counsel

PUC Schedule Q.Iaa

Hawaii Electric Light Company, Inc. • PO Box 1027 • Hilo, HI 96721-1027

8.

Warren H. W. Lee, P.E.
President

March 7, 2008

FILED

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PUBLIC UTILITIES COMMISSION

Stacey K. Djou, Esq
Public Utilities Commission
of the State of Hawaii
465 South King Street
Kekuanaoa Building, 1st Floor
Honolulu, Hawaii 96813

Dear Ms. Djou:

Subject: Docket No. 2007-0220, Approval to Include the Costs of its Schedule Q Purchased Power Contract with the County of Hawaii Department of Water Supply in its Energy Cost Adjustment Clause

In response to your letter dated January 28, 2008, Hawaii Electric Light Company, Inc. ("HELCO") respectfully submits its position on whether the contract payment rates (which are based on Schedule Q) comply with Act 162, in the above subject proceeding. (See Attachment A.)

Sincerely,

Warren H W Lee

Attachment

cc: Division of Consumer Advocacy (2 copies)

DOCKET NO. 2007-0220
COUNTY OF HAWAII DEPARTMENT OF WATER SUPPLY
SCHEDULE Q PURCHASED POWER CONTRACT

INTRODUCTION

Schedule Q is made a part of the tariffs of HECO, HELCO, and MECO[1] in order to comply with the requirement in the Federal Energy Regulatory Commission ("FERC") rules implementing the Public Utilities Regulatory Policies Act of 1978, as amended ("PURPA"), and the Commission rules based on the FERC rules (Hawaii Administrative Rules, Title 6, Chapter 74), for standard rates for purchases from qualifying facilities with a design capacity of one hundred kilowatts or less: "There shall be placed into effect with respect to each electric utility, standard rates for purchases from qualifying facilities with a design capacity of one hundred kilowatts or less." Hawaii Administrative Rules ("H.A.R.") § 6-74-22(b).

For an as-available energy facility, which provides energy as the qualifying facility determines that energy to be available for purchase, "the rates for such purchases shall be based on the purchasing utility's avoided energy costs calculated at the time of delivery . . . ." H.A.R. § 6-74-22(c)(1). "Calculated at the time of delivery" means "calculated using the basic projections and assumptions used to develop the system cost data provided by an electric utility pursuant to §§6-74-17 and 6-74-18 most closely preceding the actual time of delivery . . . ." H.A.R. § 6-74-22(c). The filed avoided energy cost rates are the rates submitted pursuant to H.A.R. § 6-74-17(b). Thus, the payment rates specified in Schedule Q are based on the filed avoided energy cost rates.

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[1] Hawaiian Electric Company, Inc. is referred to as "HECO", Hawaii Electric Light Company, Inc. is referred to as "HELCO" and Maui Electric Company, Limited is referred to as "MECO". HECO, HELCO and MECO are collectively referred to as the "HECO Companies".

The method that is currently used to calculate the avoided energy cost rates and Schedule Q rates is based on a formula adopted in 1985 as a result of the Commission's generic investigation of the Schedule Q rates filed by Hawaii's electric utilities in 1982 pursuant to the Commission's avoided cost rules. See Windpower Association of Hawaii v. Hawaiian Electric Company, Docket No. 4569, Decision and Order No. 8298 (March 18, 1985).

As discussed further below, Act 162 added language to Hawaii Revised Statutes ("H.R.S.") §269-27.2(c) in 2006 concerning establishing a methodology to remove or reduce any linkages between the price of fossil fuels and the rate for nonfossil fuel generated electricity.[2] Such language only comes into play where the utility and the supplier fail to reach agreement on a rate for purchase. In this docket, HELCO and the County of Hawaii Department of Water Supply ("DWS") have reached agreement on the payment rates, which agreement is memorialized in the Schedule Q purchased power agreement ("PPA") between HELCO and County of Hawaii Department of Water Supply ("DWS"). In recognition of the implications of the added language, the HECO Companies are willing to propose a new methodology to calculate Schedule Q payment rates which will result in fixed payment rates over the term of the Schedule Q contract (which the HECO Companies are proposing to extend to 5 years).

The HECO Companies' proposed new methodologies to compute Schedule Q payment rates should be examined in detail in a new Commission proceeding instead of this docket. This

[2] The language added include the following passage to HRS §269-27.2(c):

> The commission's determination of the just and reasonable rate shall be accomplished by establishing a methodology that removes or significantly reduces any linkage between the price of fossil fuels and the rate for the nonfossil fuel generated electricity to potentially enable utility customers to share in the benefits of fuel cost savings resulting from the use of nonfossil fuel generated electricity. As the commission deems appropriate, the just and reasonable rate for nonfossil fuel generated electricity supplied to the public utility by the producer may include mechanisms for reasonable and appropriate incremental adjustments, such as adjustments linked to consumer price indices for inflation or other acceptable adjustment mechanisms.

docket involves HELCO's Schedule Q PPA with the DWS. The HECO Companies' proposed new methodologies should not delay action on the approvals requested in HELCO's application in this docket.

DISCUSSION

PURPA, the Commission's rules implementing PURPA, and the Commission approved tariffs of HECO, HELCO and MECO all require that the HECO Companies offer Schedule Q contracts to Qualifying Facilities that are small enough to qualify for Schedule Q. The energy payment rates under Schedule Q, by rule and implementing tariff, are based on the avoided energy cost rates that are currently filed on a quarterly basis under H.A.R. §6-74-17. The filed avoided energy cost rates fluctuate month-to-month with fluctuations in the HECO Companies' composite cost of fuel for certain proxy generating units. The stipulations filed in Docket No. 7310, once approved by the Commission, will implement a more accurate and reliable production simulation based methodology for the calculation of filed avoided energy cost rates. Nonetheless, the avoided energy cost rates will vary monthly with changes in the cost of fuel oil, since the energy avoided by the facilities that are paid for on the basis of filed avoided energy cost rates is primarily produced from oil-fired generating units.

The avoided energy cost rates paid to Schedule Q producers could be fixed for a reasonable period (such as five years), but still be based on avoided energy costs as is required by PURPA, as well as by H.R.S. §269-27.2(c).

In general, HELCO proposes that the revised methodology for determining Schedule Q payment rates for HELCO, HECO and Maui Division be similar to the methodology proposed in the Updated Stipulation to Resolve Proceeding ("Updated Stipulation") filed in Docket No. 7310 on December 29, 2006.[3] The calculation methodology is briefly described on page 9 of the Updated Stipulation and would use the QF-in/QF-out method for HECO, HELCO, and Maui Division of MECO.

In the QF-in/QF-out method described in the Updated Stipulation, the production simulation to determine avoided fuel costs would be performed annually, and the resulting avoided fuel costs would be available October 1 of each year for each ensuing year.[4] The updated fuel costs would be updated monthly for changes in fuel prices.[5] Under this methodology, avoided fuel costs would not be delinked from the actual price of fossil fuel. Therefore, in order to delink Schedule Q rates from actual fossil fuel prices at the time the energy is purchased, HELCO proposes to use forecasted fuel prices when using the QF-in/QF-out method to determine Schedule Q rates. In addition, HELCO proposes to determine Schedule Q rates for a five-year forward-looking period using forecasted fuel prices.[6] Once HELCO has agreed to purchase energy from a seller under Schedule Q rates, the rates of purchase would be fixed in the agreement according to this forward-looking price schedule. The rates would not change over the term of the agreement, even though actual fuel prices will change at the time the energy is purchased.

[3] As stated on page 5 of the Updated Stipulation, the parties to Docket No. 7310 generally agreed that the avoided fuel costs should be determined based on a computer production simulation model, and that avoided generation operating and maintenance ("O&M") costs should be included, adders should be calculated for avoided working cash and avoided fuel inventory, and transmission line losses should be determined on a case-by-case basis. Exhibit B of the Updated Stipulation provides the details on the methodology for determining the avoided fuel costs using the estimated amount of as-available energy, or, if less than 8,760 MWh of as-available energy is anticipated for that year, the avoided fuel cost will be determined on the basis of 8,760 MWh (1 MW) of as-available energy.
[4] Exhibit B of the Updated Stipulation, page 2, paragraph 5.
[5] Ibid, paragraph 7.
[6] Adjustments to Schedule Q payment rates were addressed in the Updated Stipulation on page 14. These adjustments would still apply in the proposed revised methodology.

In general, with respect to Schedule Q payment rates for Lanai and Molokai, in order to eliminate the linkage between the price of fuel and the rates for purchase for Schedule Q contracts, MECO proposes that rates of purchase be determined using the proxy method for five year periods without any adjustment for actual fuel prices at the time the utility purchases the energy.[7] To accomplish this, MECO proposes to use forecasted fuel prices when using the QF-in/QF-out method to determine Schedule Q rates. In addition, MECO proposes to determine Schedule Q rates for Molokai and Lanai using the proxy method for a five-year forward-looking period using forecasted fuel prices for the respective islands. Once MECO has agreed to purchase energy from a seller under Schedule Q rates, the rates of purchase would be fixed in the agreement according to this forward-looking price schedule. The rates would not change, even though actual fuel prices will change at the time the energy is purchased.

The HECO Companies base their fuel price forecasts on a projection of world oil prices contained in the Energy Information Administration's ("EIA") Annual Energy Outlook ("AEO") publication. The EIA typically releases the final AEO forecast in the first quarter of each year. The HECO Companies would use the EIA's AEO to develop their fuel price forecasts using statistical correlations between the prices of the fuels used by the HECO Companies and world oil prices as recorded in the AEO. The HECO Companies' fuel price forecast would generally be available in the second quarter of the year. To provide sufficient time for the HECO Companies to perform the avoided energy cost calculations for the forward-looking five-year

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[7] Under the existing proxy methodology to determine Schedule Q rates of purchase for MECO's Molokai and Lanai Divisions, the rates are determined by oil prices at the beginning of each quarter. As stated on page 5, paragraph 5, of the Updated Stipulation, the proxy method will be retained for MECO's Molokai and Lanai Divisions

period, the HECO Companies propose that the Schedule Q rates be available November 1 of a particular year for an ensuing five-year period.[8]

The HECO Companies' proposed new methodologies to compute Schedule Q payment rates should be examined in detail in a new Commission proceeding. This docket involves HELCO's Schedule Q purchased PPA with the County of Hawaii Department of Water Supply. The HECO Companies' proposed new methodologies should not delay action on the approvals requested in HELCO's application in this docket.

In order to avoid abrogating existing contracts, rules and tariffs, the new methodology would have to apply to "new" Schedule Q contracts entered into after the Commission's rules and the HECO Companies' tariffs have been modified to incorporate the new methodology and rules, respectively. This could be done expeditiously after the rules and tariffs have been modified, since Schedule Q contracts have a fixed term of one year, and continue thereafter

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[8] HECO discussed the EIA and general fuel forecast considerations in HECO's October 14, 2005 Comments Relating to the Renewable Portfolio Standards Technical Paper titled "Planned Computer Simulations Facilitating the Analysis of Proposals for Implementing the Renewable Portfolio Standards Provision in Hawaii" dated September 23, 2005 and Exhibit E to those comments. The EIA, created by Congress in 1977, is established as the single Federal Government authority for energy information. EIA's mission is to provide high quality, policy-independent energy information to meet the requirements of Government, industry, and the public in a manner that promotes sound policymaking, efficient markets, and public understanding regarding energy and its interaction with the economy and the environment. By law, EIA's products are prepared independently of Administration policy considerations. EIA neither formulates nor advocates any policy conclusions. Accordingly, EIA's data, forecasts and analysis are widely used by Federal and State agencies, industry, media, consumers and educators.

Few, if any, entities or individuals that analyze the energy market can dedicate resources comparable to that of EIA or match the depth and breadth of their integrated analysis. EIA collects, analyzes and disseminates information on petroleum, natural gas, electricity, coal, nuclear, renewable fuels and alternative fuels. The EIA's energy data and analysis are fundamentals based, focusing on supply, demand, prices, forecasts, related economic and environmental issues, and finance. EIA issues a wide range of weekly, monthly and annual reports on energy production, stocks, demand, imports, exports, and prices, and prepares analyses and special reports on topics of current interest.

unless terminated by either party. Thus, existing contracts could be terminated, and replaced with new contracts that incorporate the new rules and tariffs.[9]

Any needed modifications to the Company's tariffs could be accomplished in the separate proceeding to examine the HECO Companies' proposed new methodologies to compute Schedule Q payment rates, as described above. Further, changes or additions to the Commission's rules would be in accordance with the Subchapter 15 (Rulemaking Proceedings) in Title 6, Chapter 61 of the Hawaii Administrative Rules.

The outlined methodology would produce "fixed prices" that are consistent with H.R.S. §269-27.2(c). H.R.S. §269-27.2(c) provides that:

> The rate payable by the public utility to the producer for the nonfossil fuel generated electricity supplied to the public utility shall be as agreed between the public utility and the supplier and as approved by the public utilities commission; provided that in the event the public utility and the supplier fail to reach an agreement for a rate, the rate shall be as prescribed by the public utilities commission according to the powers and procedures provided in this chapter.
>
> In the exercise of its authority to determine the just and reasonable rate for the nonfossil fuel generated electricity supplied to the public utility by the producer, the commission shall establish that the rate for purchase of electricity by a public utility shall not be more than one hundred per cent of the cost avoided by the utility when the utility purchases the electrical energy rather than producing the electrical energy.
>
> The commission's determination of the just and reasonable rate shall be accomplished by establishing a methodology that removes or significantly reduces any linkage between the price of fossil fuels and the rate for the nonfossil fuel generated electricity to potentially enable utility customers to share in the benefits of fuel cost savings resulting from the use of nonfossil fuel generated electricity. As the commission deems appropriate, the just and reasonable rate for nonfossil

[9] The "Term" provision in HELCO's Schedule Q PPA with the County of Hawaii Department of Water Supply states "[t]his Contract shall remain in effect for a minimum term of one year and shall continue in effect on a year-to-year basis thereafter. Either the Company or the Seller may terminate the agreement at any time after the end of this minimum term upon ninety (90) days' written notification." HELCO's Application filed August 3, 2007, Attachment 1 at 3.

fuel generated electricity supplied to the public utility by the producer may include mechanisms for reasonable and appropriate incremental adjustments, such as adjustments linked to consumer price indices for inflation or other acceptable adjustment mechanisms.

The third paragraph was added in 2006 pursuant to Act 162. The language was intended to reflect the success of MECO in negotiating a Power Purchase Contract for As-Available Energy dated December 3, 2004, with Kaheawa Wind Power, LLC ("KWP") (the "KWP PPC"), in which 70% of the energy payments that MECO makes to KWP are based on a fixed payment rate.[10]

Section VI of the Application in Docket No. 04-0365 ("KWP Application") describes the fixed pricing component, and the derivation of the fixed pricing component, as follows: The fixed energy price component in the KWP PPC begins at 8.455¢/kWh on-peak and 7.457¢/kWh off-peak for payment year 2006. The fixed price is escalated at 1.5% per year in payment years 2007 through 2021.[11] Thereafter, there is no escalation in the fixed price component.

The pricing structure was determined through a series of proposals and negotiations between KWP and MECO. Key objectives in the negotiations included KWP's considerations in developing an economically viable long-term wind farm project, the parties' desire to achieve a more stable energy pricing, MECO's desire for renewable power, and MECO's desire to accommodate KWP's wishes for quick execution of a contract to the extent practical. Factors

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[10] The remaining 30% is based on MECO's avoided energy cost data filed with the Commission pursuant to Hawaii Administrative Rules §6-74-17(b), as may be amended from time to time or as may be superseded by applicable laws, rules or Commission orders. The PPC has on-peak and off-peak energy prices, both of which are based on a combination of both a fixed and a variable pricing component. See Application filed December 16, 2004, in Docket No. 04-0365, for approval of the KWP PPC.

[11] Therefore, payment years 2021 through 2025 have prices of 10.571¢/kWh on-peak and 9.323¢/kWh off-peak. For energy delivered subsequent to 2025, the Fixed Energy Payment Rates (on- and off-peak) to be used to calculate the Total Energy Payments will be the on- and off-peak rates for year 2025. KWP PPC, Appendix D, Section 3(e).

considered in order to attain these objectives included KWP's and MECO's expectations for future oil prices over the long term, MECO's current filed avoided energy cost rates, MECO's estimated long-run avoided energy costs based on its current fuel oil forecast, historical fluctuations in filed avoided energy cost rates, and current fuel prices relative to the current MECO fuel oil forecast. KWP Application at 12. A more detailed description of the process was provided in response to CA-IR-16, filed January 28, 2005, pursuant to Protective Order No. 21559 (January 27, 2005).

The agreed-upon fixed pricing component decoupled the wind farm energy prices from the actual price of oil at the time the energy is delivered. This was intended to reduce the energy price volatility and provide a benefit to MECO's customers in the form of pricing below MECO's avoided energy costs in the event that future oil prices remain high or even further escalate. The pricing structure establishes lower fixed pricing in the early years compared to the later years, and was intended to provide a reasonable balance of the pricing risks between KWP and MECO's customers. KWP Application at 13.

Under PURPA, the Commission's avoided cost rules,[12] and H.R.S. §269-27.2, electric utilities are required to pay purchase prices for the as-available energy produced by Qualifying Facilities and non-fossil fuel generators based on the utilities' avoided energy costs.[13] To comply with PURPA, the Commission's rules promulgated under PURPA, and the second paragraph of H.R.S. §269-27.2(c), the "fixed" rates set pursuant to the third paragraph of §269-27.2(c) must take into account the energy costs avoided by the utility in purchasing the energy from the non-fossil fuel

[12] The Commission's avoided cost rules in HAR 6-74 are based on the Federal Energy Regulatory Commission's ("FERC") rules, which were adopted pursuant to PURPA.
[13] See H.A.R. § 6-74-22(c) (1), which refers to avoided energy costs calculated at the time of delivery. Such short-run avoided energy cost rates for on-peak and off-peak energy are currently filed on a quarterly basis pursuant to H.A.R. § 6-74-17(b). These rates would be adjusted monthly based on the stipulation and updated stipulation filed in Docket No. 7310.

producer. As was the case with the KWP PPC, this is done by determining or otherwise taking into consideration the utility's avoided energy costs, which primarily consist of avoided oil costs, and then levelizing the resulting avoided energy costs on a discounted present value basis over the relevant payment period.[14] To comply with the requirement that avoided energy costs reflect the energy costs avoided at the time of delivery of the energy, the HECO Companies propose that that the avoided energy costs be calculated for a period of five years.

CONCLUSION

As explained above, the provision added by Act 162 concerning establishing a methodology to remove or reduce any linkages between the price of fossil fuels and the rate for nonfossil fuel generated electricity only comes into play where the utility and the supplier fail to reach agreement on a rate for purchase. In this docket, HELCO and the DWS have reached agreement on the payment rates. Thus, HELCO urges the Commission to approve the application in this proceeding without delay. However, in recognition of the implications of the language added by Act 162, the HECO Companies are willing to propose a new methodology to calculate Schedule Q payment rates which will result in fixed payment rates over the term of the Schedule Q contract (which the HECO Companies are proposing to extend to 5 years). The HECO Companies' proposed new methodologies to compute Schedule Q payment rates should be examined in detail in a new Commission proceeding instead of this docket.

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[14] For power purchase agreements that involve facilities that are substantially larger than the 100 KW limit in Schedule Q, the resulting avoided energy cost can be compared to and limited by a "proxy" avoided energy cost based on the utility's cost to construct and own a renewable energy facility. This would take into account the utility's ability to avoid fossil-fuel based energy costs by constructing and operating its own renewable energy facilities, and would allow utility customers "to share in the benefits of fuel cost savings resulting from the use of nonfossil fuel generated electricity" in accordance with H.R.S. §269-27.2(c). It does not make sense to go through this exercise in the case of very small Schedule Q facilities.

CERTIFICATE OF SERVICE

I hereby certify that I have this date served a copy of the foregoing Order No. 24157 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: April 18, 2008