

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF HAWAII

----In the Matter of----)
)
PUBLIC UTILITIES COMMISSION)
)
Instituting a Proceeding To)
Examine Hawaiian Electric)
Company, Inc., Hawaii Electric)
Light Company, Inc., and Maui)
Electric Company, Limited's)
Proposal for a Renewable Energy)
Infrastructure Program)
_____)

DOCKET NO. 2007-0416

DECISION AND ORDER

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PUBLIC UTILITIES
COMMISSION

FILED

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DECISION AND ORDER

By this Decision and Order, the commission:
(1) approves, with conditions, the proposal of HAWAIIAN ELECTRIC COMPANY, INC. ("HECO"), HAWAII ELECTRIC LIGHT COMPANY, INC. ("HELCO"), and MAUI ELECTRIC COMPANY, LIMITED ("MECO") (collectively, "HECO Companies")¹ for a Renewable Energy Infrastructure Program ("REIP"), including a Renewable Energy Infrastructure Program Surcharge ("REIP Surcharge"); and
(2) denies the HECO Companies' proposal for a consolidation incentive mechanism ("Consolidation Incentive").

¹The parties to this docket are: the HECO Companies, KAUAI ISLAND UTILITY COOPERATIVE ("KIUC"), the DEPARTMENT OF COMMERCE AND CONSUMER AFFAIRS, DIVISION OF CONSUMER ADVOCACY ("Consumer Advocate"), LIFE OF THE LAND ("LOL"), and HAWAII RENEWABLE ENERGY ALLIANCE ("HREA") (collectively, "Parties").

I.

Background

A.

RPS Docket

By Order No. 23191, filed on January 11, 2007, the commission initiated Docket No. 2007-0008, citing Act 162 (Haw. Sess. L. 2006), which, among other things, authorized the commission to establish and issue penalties against electric utility companies that fail to meet Hawaii's Renewable Portfolio Standards ("RPS").

Under Hawaii Revised Statutes ("HRS") §§ 269-91 to 269-95, Hawaii's RPS law ("RPS Law"), RPS is defined as the percentage of electrical energy sales that is represented by renewable electrical energy. See HRS. § 269-91. The RPS Law previously required each electric utility company that sells electricity for consumption in the State to meet the RPS of: (1) ten percent of its net electricity sales by December 31, 2010; (2) fifteen percent of its net electricity sales by December 31, 2015; and (3) twenty percent of its net electricity sales by December 31, 2020. However, the RPS Law was recently amended by Act 155 (Haw. Sess. L. 2009), which increased electric utilities' 2020 RPS requirement from 20% to 25%, and added a new 40% requirement for the year 2030. In addition, whereas prior to January 1, 2015, only 50% of a utility's RPS needed to be met by "electric generation using renewable energy as the source," after January 1, 2015, pursuant to Act 155, a utility's entire RPS will

need to be met by renewable generation, and "electrical energy savings" (i.e., energy efficiency) will no longer be counted toward RPS requirements.

In Order No. 23316, filed on March 23, 2007, the commission set forth the issues for the RPS docket, including:

What is the appropriate utility ratemaking structure to establish and include in the commission's RPS framework under HRS § 269-95 to provide incentives that encourage electric utilities to use cost-effective renewable energy resources found in Hawaii to meet the RPS, while allowing for deviation from the standards in the event that the standards cannot be met in a cost-effective manner, or as a result of circumstances beyond the control of the utility that could not have been reasonably anticipated or ameliorated?²

In their stated response to this issue, on July 25, 2007, the HECO Companies filed a Supplemental Preliminary Statement of Position, describing the HECO Companies' proposal for the REIP.

On October 12, 2007, the HECO Companies, KIUC, the Consumer Advocate, and HREA filed a Stipulation and Joint RPS Framework. Among other things, the Joint RPS Framework: (1) provided an RPS penalty framework; (2) proposed a Temporary REIP Surcharge; and (3) proposed that the commission adopt a Consolidation Incentive that would generally operate so as to credit customers of electric utility affiliates within a consolidated electric utility whose service territories exceed their RPS percentage on a stand-alone basis, to be paid for

²Order No. 23316, filed on March 23, 2007, in Docket No. 2007-0008, at 7.

through a compensation payment or surcharge on customers of the affiliated electric utilities, if any, whose service territories fall short of their RPS percentage on a stand-alone basis.

On December 20, 2007, the commission issued Decision and Order No. 23912 ("Decision and Order No. 23912"), which approved the Framework for Renewable Portfolio Standards, but denied the proposal in the Stipulated Framework for the implementation of a Temporary REIP Surcharge and Consolidation Incentive. In particular, the commission found that:

the surcharges proposed by this program, including the surcharge to Oahu ratepayers in connection with the Consolidation Incentive, represent new rate structures that should be more appropriately considered in a separate docket with full public notice and input, and intervention or participation by interested parties Under these circumstances, with an incomplete and deficient record, it would be unreasonable and against the public interest for the commission to review and approve, even on a temporary basis, the REI Program and any projects and surcharges related to it.³

Subsequently, in an Order Relating to RPS Penalties, filed on December 19, 2008, the commission approved a penalty of \$20 for every megawatt-hour that an electric utility is deficient under the RPS.⁴ The commission specified that the HECO Companies are prohibited from recovering any RPS penalties through rates;⁵

³Decision and Order No. 23912 at 15-16.

⁴This penalty, however, may be reduced, in the commission's discretion, based on factors listed in HRS § 269-92(d) and in the Framework for Renewable Portfolio Standards, which the commission approved in Decision and Order No. 23912.

⁵See Order Relating to RPS Penalties, filed on December 19, 2008, in Docket No. 2007-0008, at 8.

thus, any RPS penalties assessed against the HECO Companies would have to be borne by shareholders, and not ratepayers.

B.

Relevant Procedural History in this Docket

Commensurate with the commission's ruling in Decision and Order No. 23912 in the RPS docket, the commission also issued Order No. 23913 on December 20, 2007, thereby initiating this docket to examine the HECO Companies' REIP that was proposed in the RPS docket. The commission named as Parties to this proceeding the same parties in the RPS docket. No other person moved to intervene or participate.

By Order No. 24056, filed on February 26, 2008, the commission, among other things, adopted a Stipulated Procedural Order filed by the Parties on February 5, 2008. The Stipulated Procedural Order included the following issue for determination in this proceeding:

Whether the HECO Companies' Proposed Renewable Energy Infrastructure Program (included as Exhibit B to the Stipulation and Joint RPS Framework, filed on October 12, 2007 in Docket No. 2007-0008), including a permanent REI surcharge and the Consolidation Incentive, is just and reasonable and should be approved and included in the RPS Framework.⁶

The commission held public meetings on May 5, 2008 in Honolulu, May 7, 2008 in Hilo, May 8, 2008 in Kona, May 12, 2008 in Kaunakakai, May 14, 2008 in Kahului, and May 15, 2008 in

⁶Order No. 24056, filed on February 26, 2008, Exhibit A at 3.

Lanai City, at which members of the public provided testimony to the commission on matters related to the REIP, as well as other matters.

HREA, the Consumer Advocate, and LOL filed Statements of Position on July 28, July 29, and August 1, 2008, respectively. The Consumer Advocate recommended approval of the REIP and REIP Surcharge. HREA also supported the REIP and REIP Surcharge. LOL, "[a]fter thoughtful review . . . [did] not oppose this mechanism."⁷

On September 17, 2008, the HECO Companies filed their Reply Statement of Position ("Reply SOP").

By letter dated October 13, 2008, the commission directed the Parties to provide notification on whether the Parties had reached an agreement on all of the issues in this docket; and if so, whether they would waive an evidentiary hearing.

By letter dated October 22, 2008, the Parties informed the commission that they: (1) reached an agreement on all of the issues in this docket; (2) agreed that it is appropriate that the commission approve the HECO Companies' proposed REIP and related REIP Surcharge; (3) agreed that, with respect to the Consolidation Incentive, the commission should generally approve the mechanism in this proceeding and reserve for itself and the Parties the opportunity to more fully review the cost sharing for a proposed project when such application is

⁷LOL's Statement of Position, filed on August 1, 2008, at 1.

filed; (4) agreed that renewable energy implementation study projects would be recovered through the REIP Surcharge after the study project is approved by the commission; (5) agreed that the record in this proceeding is complete and ready for commission decision-making; and (6) waived an evidentiary hearing.

By letter dated November 12, 2008, the commission informed the Parties that it would review the Parties' settlement on the REIP in conjunction with the Clean Energy Infrastructure Surcharge ("CEIS") described in the October 20, 2008 Energy Agreement among the State of Hawaii, Division of Consumer Advocacy of the Department of Commerce and Consumer Affairs, and the Hawaiian Electric Companies ("Energy Agreement"),⁸ upon submission to the commission. By letter dated November 28, 2008, the HECO Companies and the Consumer Advocate stated that the proposed REIP Surcharge is "substantially similar to the CEIS included in the Energy Agreement," and that "no further regulatory action by the Commission is necessary at this time with respect to the CEIS."

⁸On January 31, 2008, the State of Hawaii and the U.S. Department of Energy entered into a Memorandum of Understanding designed to establish a partnership, called the Hawaii Clean Energy Initiative ("HCEI"). The partnership aims to have 70% of all of Hawaii's energy needs generated by renewable energy sources by 2030. A product of HCEI, the Energy Agreement is a commitment on the part of the State and the HECO Companies to accelerate the addition of new, clean resources on all islands; to transition the HECO Companies away from a model that encourages increased electricity usage; and to provide measures to assist consumers in reducing their electricity bills. The Energy Agreement contemplated increases to the RPS that became codified in the RPS Law, via Act 155, discussed above.

By letter dated February 3, 2009, the commission directed the Parties to separately respond, within thirty days, to information requests ("IRs") that were prepared by the commission's consultant, the National Regulatory Research Institute. In response to the commission's directive, the Consumer Advocate filed its IR responses on March 5, 2009. The HECO Companies and HREA each filed their IR responses on March 9, 2009.

By letter dated May 18, 2009, the commission directed the Parties to file legal briefs generally concerning the commission's express or implied authority to approve the REIP Surcharge. In response, the Consumer Advocate and the HECO Companies filed legal briefs on July 2, 2009 and July 6, 2009, respectively.

C.

Description of the HECO Companies' Proposals

1.

REIP

a.

Summary

As described by the HECO Companies, the REIP consists of: (1) renewable energy infrastructure projects to encourage development of third-party renewable energy resources, maintain current renewable energy resources, and enhance energy choices for customers while maintaining acceptable levels of reliability;

and (2) the creation and implementation of the REIP Surcharge that is intended to facilitate raising capital by providing investors assurance of a mechanism to recover the HECO Companies' investment in renewable infrastructure in a timely fashion.⁹

To justify the need for the REIP, the HECO Companies maintain that: (1) they need to be able to acquire the renewable energy resources that are necessary for them to meet not only the current RPS, but any revised RPS that may be established as a result of the HCEI and any green house gas emissions reductions targets that may be set by state or federal legislation; and (2) the addition of renewable energy resources to the HECO Companies' systems should be accelerated, since world oil costs are volatile and renewable energy projects can often be structured to offer a "fixed" energy price that is delinked from fluctuations in oil prices at the time the energy is delivered.¹⁰

More specifically, the HECO Companies assert that authorization of the REIP Surcharge is needed now because: (1) the HECO Companies need the authority to offer to pay for certain interconnection facilities for independent power producer ("IPP") renewable energy projects on Maui, Oahu, and the Big Island, and to recover the costs of such facilities through the proposed REIP Surcharge; (2) the HECO Companies are preparing to install Advanced Metering Infrastructure ("AMI") in their service territories; and (3) the HECO Companies' credit rating

⁹See HECO Companies' Reply SOP at 4-5.

¹⁰See *id.* at 5.

was downgraded in May 2007, and adding to the capital requirements of the HECO Companies without demonstrating support for their timely ability to earn on and recover that investment would exacerbate that credit quality situation.¹¹ Stated differently, to avoid regulatory lag, the HECO Companies suggest that "traditional ratemaking should be supplemented with other ratemaking tools, such as the proposed REIP Surcharge, which would allow cost recovery to begin as soon as new facilities go into service."¹²

According to the HECO Companies, the REIP generally is not a means of raising capital prior to the approved projects' installation and use, but is intended to recover the revenue requirement of a REIP project until the revenue requirement is included in base rates; nor is it a "rate increase" in that base rates established in a rate case would be unaffected by the REIP Surcharge.¹³

b.

REIP Projects

The HECO Companies attached as Exhibit C to their Reply SOP a list and description of their proposed near-term renewable energy infrastructure projects that could be included in the REIP and recovered through the REIP Surcharge.

¹¹See id. at 5-6.

¹²Id. at 15.

¹³See id. at 14. The HECO Companies also briefed this issue in detail in their Legal Brief Regarding REIP Surcharge Issues, filed on July 6, 2009.

The HECO Companies are not proposing that electric utilities be permitted to recover the costs of central station generation-related assets (such as a wind farm) or similar utility renewable energy generation assets through the REIP Surcharge; rather, the HECO Companies have identified three general categories of infrastructure projects that may be included in the REIP.¹⁴ The HECO Companies explain that the first category consists of projects that are needed to maintain currently existing renewable energy projects; the second category consists of projects to improve their ability to accept more renewable energy on their system, and the third category consists of projects that encourage or enhance renewable energy choices for customers:

The first category of [REIP projects] encompasses projects that are necessary to maintain current renewable energy resources and/or connect new renewable energy projects to any of the HECO Companies' respective systems. This category of projects consists of renewable energy infrastructure projects such as transmission lines, interconnection equipment, substations, and related equipment necessary to bring renewable energy to the system. This category is necessary because, historically, many renewable energy IPP projects, such as wind farms, biomass plants, and hydroelectric plants were not located in close proximity to the electric grid. These renewable energy projects must overcome substantial economic barriers related to higher initial capital outlays in constructing transmission lines, switching stations and installing other interconnection equipment. Moreover, by taking responsibility for building the

¹⁴See id. at 9.

infrastructure needed for additional third-party renewable generation resources, the HECO Companies will encourage third parties to develop additional renewable generation.

The second category consists of projects that encourage development of renewable energy resources by making it possible to accept more renewable energy on a utility's electric system. This category of projects includes infrastructure projects that assist in the integration of as-available and other non-dispatchable renewable projects onto the electric grid. Many renewable projects, by their very nature, provide power on a variable basis, thus requiring offsetting firm generation as backup. Hawaii's island electric systems have difficulty accepting renewable generation during minimum load periods due to the fairly low loads during these off-peak periods compared with existing levels of baseload and non-regulating generation in operation during these minimum load periods. Systems such as battery energy storage and pumped hydroelectric storage facilities allow a utility to accept and accommodate more as-available renewable energy.

The third category generally consists of those projects that encourage renewable choices and/or otherwise enhance renewable energy choices for customers. Infrastructure projects and other utility projects can encourage renewable choices by facilitating conservation and efficient energy use or otherwise enhancing renewable energy choices for customers. There are a variety of projects that could encourage renewable energy choice, which include the selection of renewable resources as well as allowing a user to use less nonrenewable resources. Systems such as smart meters should allow customers to monitor their own consumption and use of electricity and allow for future time-based pricing programs.¹⁵

¹⁵Id. at 9-10.

Assuming commission approval of the REIP and the REIP Surcharge, the HECO Companies would file applications with the commission for approval of specific projects under the REIP. The applications would provide supporting details for REIP projects, including project need, project description and scope, project cost estimates, and the proposed cost recovery mechanism, including the estimated REIP Surcharge factor associated with the project. The HECO Companies intend to bring REIP projects to the commission for approval even if they are under the \$2.5 million threshold under General Order No. 7.¹⁶ After commission approval for a project has been obtained, the HECO Companies would build the project with the normal regulatory support (e.g., recovery of allowance for funds used during construction ("AFUDC")).

c.

REIP Surcharge

The HECO Companies propose that, after a project has been deemed used or useful for utility purposes,¹⁷ the HECO Companies would include the project in the REIP Surcharge.¹⁸

¹⁶Rule 2.3.g.2 of General Order No. 7, as modified by Decision and Order No. 21002, filed on May 27, 2004, in Docket No. 03-0257, requires electric utilities to request approval of proposed capital expenditures for any single project in excess of \$2.5 million (net of Contributions in Aid of Construction ("CIAC")).

¹⁷See HRS § 269-16(b)(3).

¹⁸This proposed cost-recovery method contrasts with the traditional regulatory approach, in which project cost recovery must await the commission's approval in a general rate case that includes the project's costs.

The amount of the REIP Surcharge for any particular project would take into account the cost of the project, the current authorized rate of return on rate base, and the project's estimated depreciation lifetime. Based on the foregoing, a surcharge factor specific to the project would be determined.

As a general statement, the HECO Companies maintain that they should be allowed to recover the costs of an approved REIP project, including capital and deferred costs relating to software development and licenses, through the REIP Surcharge.¹⁹ In particular, the HECO Companies contend that the following costs should be eligible for inclusion under the REIP Surcharge:

1. allowed rate of return or other form of return mechanism (set in the last rate case of the utility where the project is located) on the investment from the in-service date of the project;
2. depreciation (at a rate and methodology to be set forth in the project's application) to begin the month after the in-service date of the project;
3. AFUDC, applicable taxes, and other capital and deferred expense related charges; and
4. other relevant costs as approved by the commission in a request for approval to include the costs of the project in the REIP Surcharge.²⁰

¹⁹The HECO Companies confirmed that they are seeking recovery of deferred costs relating to software development and licenses through the REIP Surcharge in their response to PUC-IR-5, dated March 9, 2009.

²⁰See HECO Companies' Reply SOP at 11.

The HECO Companies state that if AMI capital costs (e.g., return on and return of capital) are allowed to be recovered through the REIP Surcharge, such capital costs would be offset by the net benefits of implementing AMI (e.g., cost savings and revenue enhancements offset by O&M expenses), as those benefits are obtained by the electric utility. In addition, the HECO Companies state that the costs of all projects to be included in the proposed surcharge will be approved in advance by the commission, subject to the utility providing an explanation of actual costs incurred in excess of 10% of the approved cost amount, similar to what is currently done for projects over \$2.5 million (e.g., Rule 2.3.g.2 projects (net of CIAC)).²¹

The HECO Companies' proposal contemplates that there may be more than one REIP project included in the REIP Surcharge, and that costs to be included in the REIP Surcharge will be totaled to determine the overall factor for cost recovery. In general, the costs for a specific REIP project would continue to be included in the REIP Surcharge until such time as the remaining costs of the project are included in the revenue requirements of the utility in a general rate case, and an interim or final decision and order is issued by the commission authorizing the company to include in its rates the costs associated with the project.

²¹See HECO Companies' response to PUC-IR-6, dated March 9, 2009.

The REIP Surcharge is proposed to be a "cents per kilowatt-hour" ("kWh") surcharge applicable to all rate schedules.²² Revenues recovered through the surcharge would be compared to the actual costs to be recovered, and a reconciliation will be performed on an annual basis. A "true-up" mechanism filed on or about May 31 of the following year would be used by each utility to reconcile the actual revenue recovered through the REIP Surcharge with actual project costs, and the balance would result in cents/kWh adjustments to the HECO Companies' respective REIP Surcharges. In addition, any over-recoveries or under-recoveries of REIP project costs would be refunded or collected, with interest.²³

2.

Consolidation Incentive

The Consolidation Incentive mechanism generally would operate so as to credit customers of electric utility affiliates within a consolidated electric utility whose service territories exceed their RPS percentage on a stand-alone basis, to be paid for through a compensation payment or surcharge on customers of the affiliated electric utilities, if any, whose service territories fall short of their RPS percentage on a stand-alone basis.

²²The HECO Companies attached a draft of the proposed REIP Surcharge tariff to their response to CA-SIR-1.a, dated July 11, 2008.

²³See HECO Companies' Reply SOP at 12-13.

The stated purpose of the Consolidation Incentive is to: (1) encourage the generation of renewable electrical energy on islands with greater potential to generate such energy; and (2) compensate the customers of affiliate utilities that procure greater amounts of renewable electrical energy for all or part of the cost of acquiring the surplus amount of renewable electrical energy in excess of their RPS percentage on a stand-alone basis.

The HECO Companies intend to provide more detailed information on the proposed REIP projects, including estimated bill impacts from the Consolidation Incentive, if applicable, in applications for specific projects. The HECO Companies propose a range of 25% to 50% for cost-sharing purposes, but note that cost-sharing amounts will ultimately be determined by the commission in individual REIP project dockets.²⁴ The credits and payments approved by the commission would be passed through to customers, and recovered by the utility, by means of the REIP Surcharge. The costs of an REIP project that are not shared and are recovered initially through the REIP Surcharge would generally be placed into base rates in the next rate case of the utility that owns the REIP project.²⁵

Regarding the need for the Consolidation Incentive, the HECO Companies cite HRS § 269-93, which allows the HECO Companies

²⁴See id. at 17-18.

²⁵See HECO Companies' responses to CA-SIR-3.b and CA-SIR-1.a, dated July 11, 2008.

to meet the RPS on a consolidated-company basis, rather than on an island-by-island basis.²⁶ The HECO Companies then explain:

Currently, renewable energy facilities utilizing Hawaii's renewable resources, such as geothermal, wind and biomass, are more easily developed and are often only available on the neighbor islands. The costs associated with such projects are absorbed by those customers on the neighbor islands. Unfortunately, there are far fewer suitable sites (and there is probably less community support as well) for substantial renewable resources on Oahu, even though Oahu contributes most to the total kWh sales against which the consolidated RPS energy targets must be measured. In effect, Oahu benefits from the neighbor islands' implementation of renewable energy projects without the associated cost.²⁷

Thus, the HECO Companies propose that the REIP be further enhanced by giving the neighbor islands additional incentive, via the Consolidation Incentive, to implement renewable infrastructure projects.

The HECO Companies, however, acknowledge that "the affiliate utility receives benefits from the addition of the renewable energy resource" which include: "(1) importing less fossil fuel; (2) emitting less emissions; and (3) requiring less water use. Moreover, the acquiring utility's customers should also benefit from the cheaper renewable energy, to the extent

²⁶HRS § 269-93 specifically provides: "An electric utility company and its electric utility affiliates may aggregate their renewable portfolios in order to achieve the renewable portfolio standard."

²⁷HECO Companies' Reply SOP at 19.

that the cost of that energy is less than they currently pay for fossil fuel supplied energy."²⁸

II.

Discussion

A.

REIP

HRS § 269-16(a) requires, in relevant part, that "[a]ll 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." [Emphasis added.] Accordingly, the commission must determine whether the REIP, as proposed by the HECO Companies, including the REIP Surcharge is "just and reasonable" under HRS § 269-16(a).

The commission acknowledges the importance of the first component of the REIP -- the identification and development of renewable energy infrastructure projects to encourage advancement of third-party renewable energy resources -- as embodying sound policy that is consistent with State law and the State's energy policy. The present record, however, is not entirely convincing as to the need for the REIP Surcharge, as proposed by the HECO Companies, in order to enable them to finance and build the infrastructure, or that the REIP Surcharge, from a cost-benefit perspective, will be in the public interest.

²⁸HECO Companies' Reply SOP at 18.

More specifically, the HECO Companies were unable to quantify the extent to which implementation of the REIP Surcharge will improve the HECO Companies' financial status and bond ratings. Likewise, the HECO Companies did not quantify the potential benefit to ratepayers of: (i) early and more complete cost-recovery of renewable energy infrastructure costs via the REIP Surcharge; and (ii) any reduction to the HECO Companies' financial risk stemming from the REIP Surcharge.

The HECO Companies' pending request to implement a decoupling mechanism also raises questions as to the need for the REIP Surcharge. In Docket No. 2008-0274, the HECO Companies proposed a revenue adjustment mechanism ("RAM"), which would provide for recovery, on an annual basis, of costs associated with, among other things, newly completed rate base additions between rate cases. Although the HECO Companies propose that the RAM will not include REIP projects, the record is still unclear as to the need for the REIP Surcharge given the potential overlap with the RAM as a cost-recovery mechanism.

In addition, on the issue of need for the REIP Surcharge, there is little evidence showing the actual cost and benefits of using the REIP Surcharge as opposed to timing general rate cases to minimize any regulatory lag associated with cost-recovery of renewable projects. Although the HECO Companies provided information regarding when they anticipate REIP projects to come into service, the information provided does not show a recurring series of investments that the HECO Companies and the commission could not address through general rate cases.

In terms of the mechanics of the REIP, the commission is concerned that the REIP Surcharge has the potential to create a "single-issue ratemaking" issue, where cost increases related to a specific project might be allowed immediate recovery through the REIP Surcharge, without considering changes in other costs or revenues associated with the project. For example, new transmission facilities may reduce necessary line maintenance and related expenses for the utility. While the REIP Surcharge allows HECO to recover the capital expenses associated with the transmission facilities between rate cases, it does not reflect the potential savings associated with reduced line losses, line maintenance, and other factors. An REIP Surcharge should account for and be adjusted for such savings or benefits that will accrue to the company as a result of a project.

The REIP also results in a transfer of risk from shareholders and developers to ratepayers. The REIP Surcharge provides almost immediate return on and return of shareholder investments, and reduces the utility's risk and any uncertainty in the recovery of such investments. The REIP Surcharge also improves the HECO Companies' access to capital and their ability to carry debt.²⁹ Moreover, as noted in Docket No. 2008-0273 relating to the commission's investigation of feed-in tariffs,

²⁹The HECO Companies state that "[t]he [REIP Surcharge] improves the utility's ability to raise capital. The [REIP Surcharge] provides assurance of the opportunity for timely recovery of investment and adequate returns on investment. This assurance reduces financial risk and increases access to capital markets." HECO Companies' response to PUC-IR-8, dated March 9, 2009; see also HECO Companies' response to PUC-IR-7, dated March 9, 2009.

renewable project developers have historically paid for up-front interconnection costs associated with a renewable project.³⁰ This method helps to assure that the developer, and not the ratepayer, bears the financial risk associated with the interconnection costs if the project ultimately does not come on-line. The REIP Surcharge, as proposed, contemplates a transfer of these risks from shareholders and developers to ratepayers.

The record, however, presently does not show that the REIP will provide ratepayers with quantifiable economic benefits, including, for example, a reduced rate of return for the HECO Companies, in return for the assumption of these risks.

The HECO Companies note that they would include the capital costs of projects in the REIP Surcharge only after the project is deemed used and useful for utility purposes. In their description of planned interconnection projects to be included in the REIP, however, the HECO Companies state that facilities would be placed in service prior to the commercial operation of a wind farm to facilitate startup activities for the wind farm project. If a given wind development is delayed or canceled, an REIP Surcharge-funded interconnection facility might be available for utility service, but might not be used and useful for the intended purpose, and might not provide the intended benefits of an REIP Surcharge-funded project.

³⁰Specifically, HECO Tariff Rule 19, approved by the commission in Decision and Order No. 23799, filed on November 5, 2007, in Docket No. 03-0372, establishes provisions for Interconnection and Transmission Upgrades. The commission notes here that nothing in this Decision and Order is intended to modify present interconnection standards and practices under Tariff Rule 19.

Notwithstanding the foregoing concerns and unresolved issues in the record, as stated above, the commission supports the underlying important policies and goals of the REIP. Moreover, pursuant to HRS § 269-6(b), the commission "may consider the need for increased renewable energy use in exercising its authority and duties under this chapter." The commission further recognizes that a cost-recovery tool like the REIP Surcharge may have the ability to maintain the HECO Companies' financial health (although the extent is uncertain) while they pursue the objectives of the REIP and satisfy the RPS.

The commission, therefore approves the REIP and the REIP Surcharge, subject to the following conditions and limitations on the REIP Surcharge to address some of the concerns outlined above:

a. To alleviate the potential for "single-issue ratemaking," the commission will consider and require applicant to submit data concerning changes to all expenses, revenues and revenue requirements associated with a project as part of the commission's review of each project for REIP eligibility. The commission will limit its approval of REIP projects to those where direct and quantifiable changes in revenues or costs can be determined. In the commission's view, the REIP Surcharge should not be used to finance projects that affect numerous aspects of the utility's expenses and earnings, until or unless a review process is developed to effectively evaluate all of these factors. In the interim, the REIP Surcharge should be used for

relatively simple projects with few if any other related economic effects. More complex projects should be reviewed in a rate case.

b. To assure accomplishment of the commission's purpose in approving the REIP Surcharge, the HECO Companies must show, with verified and credible evidence, that a REIP project is used and useful for public utility purposes,³¹ including for purposes of facilitating or maintaining renewable energy projects and developments, rather than merely demonstrating that the project is commercially available, before the commission will allow adjustment of the REIP Surcharge.

c. The commission will require the parties in the next rate cases for HECO, HELCO, and MECO to address the effect of the REIP Surcharge on each utility's rate of return.

d. In filing applications for approval of REIP projects, the HECO Companies shall address not only project need, project description and scope, project cost estimates, and the proposed cost recovery mechanism, including the estimated REIP Surcharge factor associated with the project, but also:

- (1) the effect of REIP Surcharge cost-recovery of the project on the utility's long-term revenue requirements;
- (2) why the in-service date of the project could not be synchronized with a rate case, thereby eliminating the need for REIP eligibility; and

³¹HRS § 269-16(b)(3).

(3) annual calculations for depreciation and taxes when some method other than straight-line depreciation is used.

e. REIP Surcharge recovery shall be limited to 100% of eligible project costs expressly approved by the commission for purposes of the REIP, and any amount above that, including any additional 10% cost overage, may be reviewed for recovery in the utility's next general rate case.

f. The HECO Companies shall adjust the REIP Surcharge by any CIAC or similar fees collected from customers for an eligible REIP project.

g. The commission will review the benefits and continued need for the REIP every three years, earlier if necessary, for the HECO Companies simultaneously. To facilitate the commission's review, the HECO Companies shall file annual reports (no later than January 31 of each year) addressing topics including, but not limited to: projects that were included in the REIP and the status of cost-recovery under the REIP Surcharge; a general assessment of how the REIP worked in the preceding period; benefits of the REIP to the HECO Companies, including any improvements to the HECO Companies' credit ratings as a result of the REIP; economic benefits to ratepayers stemming from the REIP; and any problems encountered by the HECO Companies related to the REIP and any corrective measures taken by the HECO Companies in response to the problems. To further facilitate the review process, the HECO Companies shall file a report three years after implementation of the REIS Surcharge. Upon such filing,

the commission shall initiate an investigation of the REIP and REIP Surcharge and consider, among other things, whether continuation of the REIP and REIP Surcharge provide the ratepayer with a quantifiable economic benefit.

B.

Consolidation Incentive

As discussed above, the HECO Companies propose a Consolidation Incentive, allowing for the inter-affiliate transfer of cost responsibility for up to 50% of any single REIP project. The mechanism:

generally would operate so as to credit customers of electric utility affiliates within a consolidated electric utility whose service territories exceed their RPS percentage on a stand-alone basis, to be paid for through a compensation payment or surcharge on customers of the affiliated electric utilities, if any, whose service territories fall short of their RPS percentage on a stand-alone basis.³²

Unlike the REIP, the commission does not have the necessary statutory authority to approve the Consolidation Incentive. HRS § 269-16(a) requires each utility's rates to be "just and reasonable." The commission generally sets just and reasonable rates for each utility by determining that utility's costs, then establishing a revenue requirement based on those costs. It is axiomatic that a utility cannot lawfully recover in rates costs it has not incurred. Under the proposed Consolidation Incentive, however, a utility affiliate that has

³²HECO Companies' Reply SOP at 16.

not incurred REIP project costs would charge its customers for costs incurred by another affiliate. Such a result directly contravenes basic regulatory principles and HRS § 269-16(a).

Moreover, HRS § 269-93, cited by the HECO Companies, does not authorize approval of the Consolidation Incentive. That section provides: "An electric utility company and its electric utility affiliates may aggregate their renewable portfolios in order to achieve the renewable portfolio standard." This provision essentially allows an individual HECO affiliate to under-comply with its statutorily-assigned RPS obligation, provided that the sum of all of the HECO Companies' RPS efforts equals or exceeds the sum of all of the HECO Companies' RPS requirements. Importantly, this provision does not address ratemaking; only RPS compliance. In other words, the authorization of under-compliance does not translate into a legal right for one HECO affiliate to recover from its ratepayers costs incurred by another HECO affiliate.

Even if the commission had the requisite statutory authority, it is not convinced, based on the present record, that the policy basis for the Consolidation Incentive is sound. It has not been clearly established by the HECO Companies, that there will be a substantive long-term imbalance among the HECO Companies with respect to the level of renewable energy project development, or that the majority of renewable energy projects will be developed in the MECO or HELCO service territories.

The HECO Companies' description of near term projects to be financed by the proposed REIP Surcharge does not show an imbalance with respect to the infrastructure expenditures that are expected to be incurred by the HECO Companies.³³ HECO has also informed the commission of the status of various potentially successful renewable energy projects on Oahu, such as a 30 MW wind farm in Kahuku;³⁴ and other projects that may be procured through competitive bidding.³⁵ HECO is also seeking recovery of costs from Oahu ratepayers for Big Wind Implementation Studies associated with the potential development of 400 MW of wind power cabled to Oahu.³⁶ In contrast, the commission notes that the HECO Companies have stated that HELCO and MECO are experiencing difficulty with integrating additional renewable energy on their respective systems, due to the limited demand on those islands and reportedly adverse impact on system stability.

Notably, the existing record in this proceeding does not indicate that HECO customers on Oahu currently pay, or will be paying in the future, for less than their fair share of RPS compliance costs. As acknowledged by the HECO Companies, "the affiliate utility receives benefits from the addition of

³³See Application, at Exhibit "C."

³⁴See In re Hawaiian Electric Company, Inc., Docket No. 2009-0176.

³⁵See In re Public Utilities Commission, Docket No. 2007-0331.

³⁶See In re Hawaiian Electric Company, Inc., Docket No. 2009-0162 (Application, filed on July 17, 2009).

the renewable energy resource" which include: "(1) importing less fossil fuel; (2) emitting less emissions; and (3) requiring less water use. Moreover, the acquiring utility's customers should also benefit from the cheaper renewable energy, to the extent that the cost of that energy is less than they currently pay for fossil fuel supplied energy."³⁷

Accordingly, for the reasons stated above, the commission denies the Consolidation Incentive.

III.

Orders

THE COMMISSION ORDERS:

1. The HECO Companies' proposed REIP, including the REIP Surcharge, is approved, subject, however, to the matters described in this Decision and Order and the following conditions:

a. To alleviate the potential for "single-issue ratemaking," the commission will consider and require applicant to submit data concerning changes to all expenses, revenues and revenue requirements associated with a project as part of the commission's review of each project for REIP eligibility. The commission will limit its approval of REIP projects to those where direct and quantifiable changes in revenues or costs can be determined from the data and information provided by the utility for the project.

³⁷HECO Companies' Reply SOP at 18.

b. The HECO Companies shall provide verified proof that a REIP project is used and useful for purposes of facilitating or maintaining renewable energy development, rather than merely demonstrating that the project is commercially available, before the commission will allow adjustment of the REIP Surcharge.

c. The commission will require the parties in the next rate cases for HECO, HELCO, and MECO to address the effect of the REIP Surcharge on each utility's rate of return.

d. In filing applications for approval of REIP projects, the HECO Companies shall address topics, including, but not limited to:

- (1) the effect of REIP Surcharge cost-recovery of the project on the utility's long-term revenue requirements;
- (2) why the in-service date of the project could not be synchronized with a rate case, thereby eliminating the need for REIP eligibility; and
- (3) annual calculations for depreciation and taxes when some method other than straight-line depreciation is used.

e. REIP Surcharge recovery shall be limited to 100% of approved eligible project costs, and any amount above that, including any additional 10% cost overage, may be reviewed for recovery in the utility's next general rate case.

f. The HECO Companies shall adjust the REIP Surcharge by any CIAC or similar fees collected from customers or developers for an eligible REIP project.

g. The commission will review the benefits and continued need for the REIP every three years, earlier if necessary, for the HECO Companies simultaneously. To facilitate the commission's review, the HECO Companies shall file annual reports (no later than January 31 of each year) addressing topics including, but not limited to: projects that were included in the REIP and the status of cost-recovery under the REIP Surcharge; a general assessment of how the REIP worked in the preceding period; benefits of the REIP to the HECO Companies, including any improvements to the HECO Companies' credit ratings as a result of the REIP; economic benefits to ratepayers stemming from the REIP; and any problems encountered by the HECO Companies related to the REIP and any corrective measures taken by the HECO Companies in response to the problems. To further facilitate the review process, the HECO Companies shall file a report three years after implementation of the REIS Surcharge. Upon such filing, the commission shall initiate an investigation of the REIP and REIP Surcharge and consider, among other things, whether continuation of the REIP and REIP Surcharge provide the ratepayer with a quantifiable economic benefit.

2. The HECO Companies' proposal for a Consolidation Incentive is denied.

DONE at Honolulu, Hawaii DEC 30 2009.

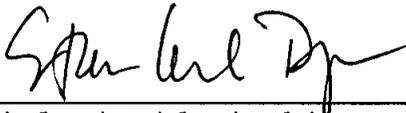
PUBLIC UTILITIES COMMISSION
OF THE STATE OF HAWAII

By 
Carlito P. Caliboso, Chairman

By 
John E. Cole, Commissioner

By _____
Leslie H. Kondo, Commissioner

APPROVED AS TO FORM:



Kaiulani Kidani Shinsato
Commission Counsel

for
2007-0416.laa

CERTIFICATE OF SERVICE

The foregoing Decision and Order was served on the date of filing by mail, postage prepaid, and properly addressed to the following parties:

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