BEFORE THE PUBLIC UTILITIES COMMISSION

OF THE STATE OF HAWAII

In the Matter of the Application of VERIZON HAWAII INC. For Exemption From and Modification of General Order No. 8, Paragraph 2.3.d(2), and Hawaii Administrative Rules § 6-80-90(b), Relating to Capital Improvements.	DOCKET NO. 03-0258

DECISION AND ORDER NO. 21008

Filed May 28, 2004

At 11:00 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.

K. Higashi

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DECISION AND ORDER

I.

Introduction

VERIZON HAWAII INC. seeks to increase the monetary threshold that triggers the filing of capital expenditure applications with the commission, from $500,000 to $3 million, exclusive of customer contributions.[1] Verizon Hawaii Inc. makes its request pursuant to Hawaii Administrative Rules ("HAR") § 6-80-135 and General Order No. 8, *Standards for Telephone Service in the State of Hawaii* ("GO No. 8").

Verizon Hawaii Inc. served a copy of its application upon the Department of Commerce and Consumer Affairs, Division of Consumer Advocacy ("Consumer Advocate")(collectively, the "Parties"). The Consumer Advocate does not object to

[1]Verizon Hawaii Inc.'s application, filed on September 12, 2003.

Verizon Hawaii Inc.'s request, subject to certain conditions.[2] In response to said conditions, the Parties entered into a joint agreement, filed on May 4, 2004.

II.

Verizon Hawaii Inc.'s Request

A.

Verizon Hawaii Inc.

Verizon Hawaii Inc. is the incumbent telecommunications carrier and provider of telecommunications services throughout the State of Hawaii. It operates an intrastate telecommunications network that transmits communications by fiber optics, microwave, and other means.

B.

Hawaii Administrative Rules

A telecommunications carrier that provides noncompetitive telecommunications service "shall submit to the commission for review proposed capital expenditures for any single project related to plant replacement, expansion, or modernization, that is estimated to exceed $500,000." HAR § 6-80-90(b).[3]

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[2]Consumer Advocate's position statement, filed on December 23, 2003.

[3]HAR § 6-80-90(b) reads, in pertinent part:

> (b) A telecommunications carrier receiving State or federal universal service fund subsidy for providing basic service in a high cost area, and a carrier providing noncompetitive service, shall submit to the commission for

The commission may, upon a telecommunications carrier's written request, "exempt or waive a telecommunications carrier or telecommunications service from the provisions of chapter 269, HRS, [chapter 6-80, HAR], or any other telecommunications-related rule, in whole or in part, upon the commission's determination that the exemption or waiver is in the public interest[.]" HAR § 6-80-135(a).[4]

Verizon Hawaii Inc. seeks an exemption from the $500,000 threshold set forth in HAR § 6-80-90(b), pursuant to HAR § 6-80-135(a).[5] Instead, as applied to itself, Verizon Hawaii Inc. proposes to: (1) increase the dollar threshold governing

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review proposed capital expenditures for any single project related to plant replacement, expansion, or modernization, that is estimated to exceed $500,000. The carrier shall submit the proposed expenditures for review at least sixty days before the commencement of construction or commitment for expenditure, whichever is earlier. . . .

[4]HAR § 6-80-135(a) states *in toto*:

> Exemption and waiver. (a) The commission may, upon its own motion or upon the written request of any person or telecommunications carrier, exempt or waive a telecommunications carrier or telecommunications service from the provisions of chapter 269, HRS, this chapter, or any other telecommunications-related rule, in whole or in part, upon the commission's determination that the exemption or waiver is in the public interest; provided that the commission may not exempt or waive a telecommunications carrier or telecommunications service from:
>
> (1) Any provisions of §269-34, HRS, or
> (2) Any provisions of this chapter that implement §269-34, HRS.
>
> (b) The applicable provisions of §269-16.9, HRS, apply to any exemptions or waivers issued by the commission.
>
> (c) The commission may hold a hearing on any proposed exemption or waiver.

[5]For guidance, Verizon Hawaii Inc. also cites to HRS § 269-16.9.

capital expenditure applications, from $500,000 to $3 million; and (2) exclude customer contributions in calculating the dollar threshold.

C.

General Order No. 8

GO No. 8, paragraph 1.2, subsections (b) and (c), provide:

> b. If unreasonable hardship to the utility or to a customer results from the application of any rule herein prescribed, application may be made to the Commission for the modification of the rule or for temporary or permanent exemption from its requirements.
>
> c. The adoption of these rules shall in no way preclude the Commission from altering or amending them, or from making such modifications with respect to their application as may be found necessary to meet exceptional conditions.

Pursuant to paragraphs 1.2, subsections (b) and (c), Verizon Hawaii Inc. seeks a permanent exemption from certain provisions of GO No. 8, paragraph 2.3(d)2, by modifying paragraph 2.3(d)2 to read as follows:[6]

> Proposed capital expenditures for any single project related to plant replacement, expansion or modernization, in excess of **[**$500,000**]** **$3,000,000, excluding customer contributions,** 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.

[6]Proposed deletion bracketed, proposed additions underscored.

III.

Verizon Hawaii Inc.'s Position

Verizon Hawaii Inc. contends that: (1) the current $500,000 threshold is unreasonable and inequitable, as applied to itself; and (2) it is the only Hawaii-based telecommunications carrier that complies with this capital expenditure requirement.

Verizon Hawaii Inc. provides the following justification in support of its exemption requests:

1. The proposed increase recognizes the effect of inflation since 1965, when GO No. 8 was promulgated.[7] By increasing the threshold, the commission will restore the application of paragraph 2.3(d)2 and HAR § 6-80-90(b) to their original intent.[8]

2. The reasonableness of increasing the threshold is confirmed when examining paragraph 2.3(d)2's second threshold -- ten (10) per cent of Verizon Hawaii Inc.'s total plant-in-service.

   Specifically, in 2002, Verizon Hawaii Inc.'s plant-in-service level was more than ten (10) times its plant-in-service level in 1965. Thus, if the same ten (10) per cent factor is applied to the $500,000 threshold established in 1965, the current threshold in 2002 dollars will be more than $5,000,000.

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[7]Verizon Hawaii Inc. estimates that $500,000 in 1965 dollars is worth: (1) $2,622,000 in 2002 dollars, based on the Honolulu Consumer Price Index for Urban Consumers ("CPI-U"); and (2) $2,871,500 in 2002 dollars, based on the United States CPI-U.

Verizon Hawaii Inc. further reasons that "if the 2002 result is extrapolated to 2004, the first full-year that any modification to the threshold will take effect, the result is $3.0 million. Therefore, it is reasonable to increase and round the threshold to $3,000,000 to reflect more closely the operating environment expected in 2004 and future years." Verizon Hawaii Inc.'s application, at 5.

[8]At the same time, Verizon Hawaii Inc. acknowledges that when HAR chapter 6-80 took effect on June 3, 1996, the capital expenditure threshold remained at $500,000.

3. The commission, Consumer Advocate, Verizon Hawaii Inc., and its ratepayers will benefit from the reduction in the number of filings that the modification should achieve, resulting in the more efficient use of available resources, and speed the deployment of capital improvements.

4. The telecommunications industry has experienced extraordinary change since 1965. In 1965, there was no competition in Hawaii. Today, the telecommunications market is extremely competitive.

5. In the twenty-eight (28) states, plus the District of Columbia, where Verizon Communications operates local telecommunications companies, no other state has an equivalent to Hawaii's rule requiring commission approval of expenditures for capital projects greater than a threshold amount.

6. Most of the capital projects that Verizon Hawaii Inc. has underway are facility upgrades for augmentations such as: installing additional trunks on a route on which capacity will be exhausted; replacing older equipment; or relocating facilities in response to a road or highway project. Such projects directly benefit customers, and the requested exemptions will assist in ensuring that these benefits reach customers in a more efficient and timely manner.

7. The portion of a capital project's cost that is funded by customer contributions offsets, in whole or in part, the increase in plant-in-service additions. Excluding these customer-contributed amounts from the threshold is reasonable and in the public interest.

   It does not book these amounts "as revenue but rather in the appropriate reserve accounts as an offset to plant-in-service."[9]

   Moreover, "there is a negative deferred income tax effect due to the capitalization of the tax liability related to the customer contributions."[10]

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[9]Verizon Hawaii Inc.'s application, at 12.

[10]Id.

Verizon Hawaii Inc. also attaches a chart, entitled "Capital Expenditure Applications Filed, 1998 - 2002," as Exhibit 2 to its application. Exhibit 2 shows that for the five (5)-year period, from 1998 to 2002, it filed a total of twenty-eight (28) capital expenditure applications, pursuant to the $500,000 threshold amount. Only two (2) of these applications exceed the proposed $3 million threshold.

IV.

Consumer Advocate's Position

Verizon Hawaii Inc. relies upon the increase in the CPI-U between 1965 and 2002 as justification for its request to increase the threshold to $3 million. The Consumer Advocate states that the increase in the CPI-U should not be the sole basis for supporting an increase in the capital expenditure threshold because there is no direct relationship between the change in the CPI-U and the change in the cost of providing utility service. Specifically, the CPI-U does not necessarily reflect the costs of goods and services purchased by a telecommunications utility company.

That said, the Consumer Advocate finds reasonable Verizon Hawaii Inc.'s request to increase the threshold from $500,000 to $3 million, exclusive of customer contributions, subject to two (2) conditions. The Consumer Advocate examined a number of factors in finding the proposed $3 million threshold reasonable, including: (1) the impact of the $3 million threshold on Verizon Hawaii Inc.'s plant in service balance; (2) the

projected decrease in capital expenditure applications resulting from the $3 million threshold; and (3) the proper balance in selecting a reasonable threshold amount.

A.

Plant in Service Balance

The existing threshold is $500,000 or ten (10) per cent of Verizon Hawaii's total plant in service, whichever is less, pursuant to GO No. 8, paragraph 2.3(d)2, and HAR § 6-80-90(b). The Consumer Advocate states that the existing threshold was established to provide the commission an opportunity to review projects that were expected to impact a utility's rate base and revenue requirements in future rate proceedings.

The Consumer Advocate finds that: (1) in 1966, $500,000 represented approximately 0.27 per cent of Verizon Hawaii Inc.'s year-end plant in service balance, while ten (10) per cent of its year-end balance was approximately $18.8 million; and (2) in 2002, $500,000 represented approximately 0.03 per cent of Verizon Hawaii Inc.'s plant in service balance, while ten (10) per cent of its year-end balance was approximately $188.9 million. Thus, over the years, the impact of a $500,000 capital expenditure project on Verizon Hawaii Inc.'s plant in service has significantly decreased. In particular, in 2002, a $500,000 project increased Verizon Hawaii Inc.'s rate base by a nominal 0.03 per cent.

In examining the impact of the proposed $3 million threshold on Verizon Hawaii Inc.'s plant in service balance, the

Consumer Advocate notes that "[t]he proposed $3 million capital expenditure filing threshold represents approximately 0.2% of the Company's last reported total utility plant in service balance amounting to $1.913 billion. This percentage is less than the relative percentage value calculated for the 1966 timeframe."[11]

B.

Capital Expenditure Applications

The Consumer Advocate notes that, had the $3 million threshold been in place during the ten (10)-year period from 1993 to 2002, the number of capital expenditure applications filed by Verizon Hawaii Inc. would have decreased from eighty-one (81) to twenty-two (22). Raising the threshold to $3 million "should result in a reduction in regulatory work for the Company, as it relates to the filing of CIP applications."[12]

C.

"Reasonable Balance"

The Consumer Advocate notes that the purpose of the capital expenditure filing requirement is to "reduce the regulatory review conducted on the utility's plant in service balance in a rate proceeding."[13] Specifically, if the regulatory review process is conducted in years between rate case filings, the regulatory agencies' workload will be better distributed and

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[11]Consumer Advocate's position statement, at 9.

[12]Id. at 14.

[13]Id. at 10.

their review of rate applications could be completed expeditiously. Thus, the threshold should represent a proper balance that reflects a reasonable percentage of the utility's annual plant additions that are subject to the regulators' pre-rate case review.[14]

The Consumer Advocate concedes that the benefits of reviewing every utility capital addition are outweighed by the cost of performing such a review. Ultimately, it concludes that the proposed $3 million threshold (exclusive of customer contributions) represents a reasonable balance, provided that the commission adopts two (2) conditions, discussed below.

D.

Two (2) Reporting Conditions

The Consumer Advocate explains that a public utility under rate of return regulation is generally precluded from increasing its revenues unless the utility's authorized rate of return or rate base is increased. Furthermore, Verizon Hawaii Inc.: (1) provides regulated and non-regulated telecommunications services; and (2) its regulated operations also offer competitive and non-competitive services separately and, on occasion, as a bundled package. Thus, cross-subsidization is a concern.

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[14]In achieving this balance, the Consumer Advocate maintains that "[t]he threshold should not be set too high, thereby allowing the utility to proceed with major projects that are not subject to regulatory review before being placed in service. On the other hand, the threshold should not be set so low that the regulator is reviewing projects that are routine and necessary for the provision of the utility service." Id.

Under this scenario, Verizon Hawaii Inc.'s "consumers of non-competitive regulated local exchange telecommunications service need assurances that the capital expenditures included in the Company's rate base are reasonable for ratemaking purposes, regardless of the cost of the capital projects."[15] To ensure that Verizon Hawaii Inc.'s ratepayers are properly protected, the Consumer Advocate urges the adoption of the following two (2) conditions:

1. Require Verizon Hawaii Inc. to include more information on the projects referenced in its five (5)-year projected capital improvements budget report annually filed with the commission by December 31st, with particular emphasis on the projects planned for the upcoming year.[16] The Consumer Advocate proposes that the report include: (A) a brief description of each project listed for the upcoming year and a statement as to the primary reasons for the project; and (B) a brief explanation of how the project relates to the overall operational objectives of Verizon Hawaii Inc.'s management. Following the filing of Verizon Hawaii Inc.'s report, the Consumer Advocate requests that Verizon Hawaii Inc. make a presentation to the commission and Consumer Advocate and provide an opportunity to discuss the projects.

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[15] Id. at 16 - 17.

[16] HAR § 6-80-90(a) requires Verizon Hawaii Inc. to annually file with the commission, by the end of each calendar year, "a capital improvements budget that projects expenditures for capital improvements during the ensuing five years. The budget must include details about the carrier's contemplated first year expenditures." See also GO No. 8, paragraph 2.3(d)(1).

2. Require Verizon Hawaii Inc. to file, by May 31st of the subsequent calendar year, a report containing a narrative list of the projects completed during the past year. Specifically, the Consumer Advocate proposes a tri-level reporting system, based on the completed project's total cost:

A. *Completed Projects with a Total Cost of Less Than $500,000.* Provide the total number of projects completed and the total cost associated with these projects.

B. *Completed Projects with a Total Cost Between $500,000 to Under $3 Million.* Itemize each completed project with the actual costs incurred, with an explanation of any deviations of plus or minus ten (10) per cent from the budgeted cost, and a general discussion of the reasons causing the variance.

C. *Completed Projects with a Total Cost of $3 Million or More.* Identify each completed project and its total cost.

V.

Verizon Hawaii Inc.'s Response

In response to the Consumer Advocate's proposed conditions, Verizon Hawaii Inc. entered into a written agreement with the Consumer Advocate (the "stipulation"). By their stipulation, the Parties agree to:

1. Modify the Consumer Advocate's first condition by: (A) applying the additional information requirement to projects in excess of $1 million; and (B) limiting the scope of the presentation to the commission and Consumer Advocate to major

projects that Verizon Hawaii Inc. anticipates working on during the upcoming calendar year, i.e., projects in the range of $500,000 and above.

2. Certain changes to the Consumer Advocate's second condition, such that the tri-level reporting system will now read as follows:

> A. *Work Orders/$500,000+.* Provide "[t]he number of work orders completed in the previous year and the total capital cost of these work orders for each major program category that exceeds $500,000. Verizon will utilize the major program categories in Exhibit C-3 in its annual construction budget as a framework."[17]
>
> B. *Completed Projects with a Total Cost in Excess of $1 Million but Less Than $3 Million.* Itemize each completed project with the actual capital costs incurred, with an explanation of any deviations of plus or minus fifteen (15) per cent from the budgeted cost, and a general discussion of the reasons causing the variance.[18]

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[17]Parties' stipulation, at 1 - 2. Section 2(A), as initially proposed by the Consumer Advocate, reads:

> A. *Completed Projects with a Total Cost of Less Than $500,000.* Provide the total number of projects completed and the total cost associated with these projects.

[18]Section 2(B) is similar to the Consumer Advocate's Section 2(B), as initially proposed, except that: (1) the category's lower range is changed from $500,000 to projects in excess of $1 million; and (2) the deviation is changed from ten (10) to fifteen (15) per cent.

C. Completed Projects with a Total Cost in Excess of $3 Million. Provide the total completed capital cost.[19]

VI.

Discussion

The Consumer Advocate's position statement and the Parties' joint response thereto ultimately represent an agreed-upon stipulation between them. The commission reviews the overall reasonableness of the Parties' agreement.

In general, this commission's analysis of capital expenditure applications involves a review of whether the project and its costs are reasonable and consistent with the public interest, among other factors. If the commission approves the utility's application, the commission in effect authorizes the utility to commit funds for the project, subject to the proviso that no part of the project may be included in the utility's rate base unless and until the project is in fact installed, and is used and useful for public utility purposes.

Undoubtedly, the cost of materials, supplies, equipment, and labor utilized in electric utility capital expenditure projects has increased in the forty (40) years since the $500,000 threshold was initially established. The commission

[19]Section 2(C) is the same as the Consumer Advocate's Section 2(C), as initially proposed, except that the category's scope is changed from "$3 million or more" to "in excess of $3 million."

is not convinced, however, that an increase to $3 million is justified at this juncture. The commission's interpretation of Verizon Hawaii Inc.'s cost data does not support a $3 million threshold. Rather, using Verizon Hawaii Inc.'s lower range of $2.6 million, the commission rounds downward, to $2.5 million.

The commission finds that $2.5 million, exclusive of customer contributions, reflects a reasonable balance that will enable the commission and Consumer Advocate to:

1. Continue their review of capital expenditures for major projects, including those projects that involve great public interest or controversy; and

2. Review such projects during the interim period between a utility's rate case filings, where, in the Consumer Advocate's words, "the work of the regulatory agencies would be better distributed and the review of the [utility's resulting] rate application could be completed expeditiously."[20]

In addition, the Parties' agreed upon annual tri-level reporting system, due by May 31st of each subsequent calendar year, together with the additional information included in Verizon Hawaii Inc.'s five (5)-year budget report, and its resulting annual, oral presentation, will aid the commission in its on-going review of Verizon Hawaii Inc.'s regulated utility operations.

The commission approves the Parties' agreement, subject to certain changes:

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[20]Consumer Advocate's position statement, at 9.

1. Adopting a $2.5 million threshold in lieu of the Parties' proposed $3 million threshold.[21]

2. For Verizon Hawaii Inc.'s five (5)-year projected capital improvements budget report, the additional information shall also include a projected timeline, i.e., the project's estimated start and completion dates, for each project that is budgeted for, or referenced in the report.

3. Verizon Hawaii Inc.'s presentation to the commission and Consumer Advocate shall include a description on the status of on-going projects in excess of $1 million or more.

The commission modifies: (1) HAR § 6-80-90(b), by inserting the phrase "exceed $2.5 million, excluding customer contributions" in place of the current "$500,000" threshold; and (2) GO No. 8, paragraph 2.3(d)(2), by inserting the phrase "$2.5 million, excluding customer contributions," in place of the "$500,000" threshold. The commission reserves the right to rescind, adjust, or amend these changes in the future, consistent with the public interest.

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[21]With the $2.5 million threshold, the scope of the Parties' agreed upon Condition No. 2(B) and (C) will also change. To wit: (1) Condition No. 2(B) will change from *Completed Projects with a Total Cost Between $1 Million to Under $3 Million*, to *Completed Projects with a Total Cost Between $1 Million to Under* ***$2.5 Million***; and (2) Condition No. 2(C) will change from *Completed Projects with a Total Cost of $3 Million or More*, to *Completed Projects with a Total Cost of* ***$2.5 Million*** *or More*.

VII.

Orders

THE COMMISSION ORDERS:

1. The Parties' agreement is approved, as modified by the commission.

2. Effective July 1, 2004, and no sooner, as applied to Verizon Hawaii Inc.: (A) HAR § 6-80-90(b) is modified by inserting the phrase "exceed $2.5 million, excluding customer contributions" in place of the current "$500,000" threshold; and (B) GO No. 7, paragraph 2.3(g)(2), is modified by inserting the phrase "$2.5 million, excluding customer contributions," in place of the "$500,000" threshold. The commission reserves the right to rescind, adjust, or amend these changes in the future, consistent with the public interest.

3. Verizon Hawaii Inc. shall include additional information on the projects referenced in its five (5)-year projected capital improvements budget report annually filed with the commission by December 31st, with particular emphasis on the projects planned for the upcoming year in excess of $1 million. Specifically, the additional information shall include: (A) a brief description of each project listed for the upcoming year, in excess of $1 million, and a statement as to the primary reasons for the project; and (B) a brief explanation of how the project relates to the overall operational objectives of Verizon Hawaii Inc.'s management. In addition, the report shall include a projected timeline, i.e., the project's estimated start and

completion dates, for each project that is budgeted for, or referenced in the report.

Following the filing of Verizon Hawaii Inc.'s report, it shall make a presentation to the commission and Consumer Advocate, with the focus on major projects Verizon Hawaii Inc. anticipates working on during the upcoming calendar year, i.e., projects in the range of $500,000 and above. Said presentation shall also include a description on the status of on-going projects in excess of $1 million or more.

4. Verizon Hawaii Inc. shall each file, by May 31st of each subsequent calendar year, a report containing a narrative list of the projects completed during the preceding year, as follows:

A. Work Orders/$500,000+. Provide the number of work orders completed in the previous year and the total capital cost of these work orders for each major program category that exceeds $500,000. Verizon Hawaii Inc. shall utilize the major program categories in Exhibit C-3 in its annual construction budget as a framework.

B. Completed Projects with a Total Cost Between $1 Million to Under $2.5 Million. Itemize each completed project with the actual costs incurred, with an explanation of any deviations of plus or minus fifteen (15) per cent from the budgeted cost, and a general discussion of the reasons causing the variance.

C. Completed Projects with a Total Cost of $2.5 Million or More. Identify each completed project and its total cost.

5. Verizon Hawaii Inc. shall conform to all of the commission's orders set forth 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 this 28th day of May, 2004.

PUBLIC UTILITIES COMMISSION
OF THE STATE OF HAWAII

By _____
Carlito P. Caliboso, Chairman

By _____
Wayne H. Kimura, Commissioner

By _____
Janet E. Kawelo, Commissioner

APPROVED AS TO FORM:

_____
Michael Azama
Commission Counsel

03-0258.cs

CERTIFICATE OF SERVICE

I hereby certify that I have this date served a copy of the foregoing Decision and Order No. 21008 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: May 28, 2004