BEFORE THE PUBLIC UTILITIES COMMISSION

OF THE STATE OF HAWAII

In the Matter of the Application of)
)
HAWAIIAN ELECTRIC COMPANY, INC.,)
HAWAII ELECTRIC LIGHT COMPANY, INC.,)
and MAUI ELECTRIC COMPANY, LIMITED) DOCKET NO. 04-0268
)
For Approval to Defer Certain)
Computer Software Development)
Costs For Item P0000571, Customer)
Information System, to Accumulate)
an Allowance for Funds Used During)
Construction During the Deferral)
Period, to Amortize the Deferred)
Costs, and to Include the)
Unamortized Deferred Costs in)
Rate Base.)
)

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DECISION AND ORDER NO. 21798

Filed May 3, 2005
At 3 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

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BEFORE THE PUBLIC UTILITIES COMMISSION

OF THE STATE OF HAWAII

In the Matter of the Application of HAWAIIAN ELECTRIC COMPANY, INC., HAWAII ELECTRIC LIGHT COMPANY, INC., and MAUI ELECTRIC COMPANY, LIMITED For Approval to Defer Certain Computer Software Development Costs For Item P0000571, Customer Information System, to Accumulate an Allowance for Funds Used During Construction During the Deferral Period, to Amortize the Deferred Costs, and to Include the Unamortized Deferred Costs in Rate Base.	)	Docket No. 04-0268 Decision and Order No. 21798

DECISION AND ORDER

The commission approves the proposed accounting treatment requested by HAWAIIAN ELECTRIC COMPANY, INC. ("HECO"), HAWAII ELECTRIC LIGHT COMPANY, INC. ("HELCO"), and MAUI ELECTRIC COMPANY, LIMITED ("MECO"), for the Customer Information System Project, described herein.

I.

Background

HECO, HELCO, and MECO (collectively, "Applicants" or "Utilities"), seek the commission's approval of various matters related to Item P0000571, the installation of a Customer Information System ("CIS") Project ("Project").[1]

Applicants make their request "pursuant to Decision and Order No. 18365 dated February 8, 2001 in Docket No. 99-0207 (HELCO's 2000 Test Year rate case), which ordered that Commission approval is required prior to incurring software development costs to be deferred and amortized for ratemaking purposes."[2]

Applicants served copies of their Joint Application upon the Department of Commerce and Consumer Affairs, Division of Consumer Advocacy ("Consumer Advocate" or "CA")(collectively, the "Parties").

On December 13, 2004, Applicants submitted revised, "more detailed" Project cost estimates and information. Thereafter, Applicants responded to: (1) the Consumer Advocate's information requests on January 31, 2005 and February 16, 2005; and (2) the commission's information requests on December 27, 2004, February 24, 2005, and April 1, 2005.

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[1]Joint Application, Exhibits A - I, Verification, and Certificate of Service, filed on August 26, 2004, as amended by Applicants' correspondence, dated December 13, 2004, with attachments (collectively, "Application" or "Joint Application"). Applicants' December 13th correspondence provides more detailed cost estimates for the CIS Project.

[2]Joint Application, at 6 and Exhibit E, at 1. Applicants are referring to the commission's ruling in HELCO's 2000 calendar test year rate case to disallow from expenses and rate base the costs associated with Project APPRISE, a computer software development project. See Decision and Order No. 18365, filed on February 8, 2001, in Docket No. 99-0207, *In re Hawaii Elec. Light Co., Inc.*

On March 17, 2005, the Parties held a technical meeting to discuss the Consumer Advocate's concerns, and tentatively agreed on certain recommendations to alleviate these concerns. The Parties, however, were unable to resolve all of their differences by the Consumer Advocate's deadline to timely file its position statement. Thus, on March 24, 2005, the Consumer Advocate filed its position statement: (1) stating its non-objection to the Utilities' purchase and installation of a new CIS; (2) expressing its concerns; and (3) memorializing the Parties' purported "understandings" agreed-upon as a result of their technical meeting.

On April 13, 2005, the Parties filed their joint letter in lieu of the Utilities' rebuttal position statement. The Parties' joint letter represents a negotiated compromise of all the issues and concerns, and is intended to replace and supersede the Consumer Advocate's recommendations set forth in its position statement.

This Decision and Order reviews the Parties' various filings, culminating in their joint letter, filed on April 13, 2005.[3]

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[3]While the Parties' joint letter is intended to replace and supersede the recommendations made by the Consumer Advocate in its position statement ("SOP"), the commission finds it prudent and informative to nonetheless review and discuss the concerns and recommendations initially raised by the Consumer Advocate. See Section VII of this Decision and Order.

II.

Issues

Applicants request the commission's approval to:

1. Defer (i.e., capitalize) certain computer software development costs for the CIS Project;

2. Accumulate an allowance for funds used during construction ("AFUDC") on the deferred costs during the deferral period;

3. Amortize the deferred costs, including AFUDC, over a ten (10)-year period, or such other amortization period the commission finds reasonable; and

4. Include the unamortized deferred costs, including AFUDC, in rate base.

III.

Customer Information System Project

Applicants currently provide electric utility service to more than 417,000 customers, as follows: (1) 287,000 customers, island of Oahu (HECO); (2) 69,000 customers, island of Hawaii (HELCO); and (3) 61,000 customers, islands of Lanai, Maui, and Molokai (MECO).

The CIS Project is described in the Joint Application, at pages 7 - 13, and the supporting exhibits thereto.[4]

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[4]See also Utilities' responses, filed on January 6, 2005 and February 16, 2005, to the Consumer Advocate's information requests.

The CIS Project involves the purchase and installation of a new, commercially available, customer information system, including the: (1) purchase of the hardware and software; (2) purchase and installation of the associated support system operations software and hardware for the system; (3) vendor evaluation and selection; (4) configuration and testing of the software to meet the Utilities' specific requirements; (5) replacement of the mainframe-based hardware components with server-based hardware components; (6) conversion and cleansing of customer data; (7) development and testing of interfaces between the new system and other systems; (8) associated training for over 650 of the Utilities' employees; and (9) post-implementation support.

IV.

Project Justification

The Utilities represent that, in support of the CIS Project:

1. The Utilities' existing customer information system, known as the Automated Corporate Customer Energy Services System ("ACCESS"), was designed in the 1980's and implemented in 1991.

2. ACCESS was designed as a basic billing and meter data information system. While operational, ACCESS is outdated, many of its components are increasingly difficult and costly to maintain, and the system is unable to meet current or future business needs. Moreover, enhancements in customer service and

billing, and the implementation of new systems, have exceeded ACCESS' capabilities, due to its technological and functional limitations.[5]

3. The Utilities' new CIS system will: (A) allow the Utilities to more quickly and accurately store, maintain, and manage customer-specific information necessary to provide basic customer service functions, such as producing bills, collecting payments, establishing service, and fulfilling customer requests in the field; and (B) have substantially greater capabilities and features than ACCESS, thus enabling the Utilities to enhance their operations, including customer service.[6]

4. These new capabilities and features will enable the Utilities to: (A) update and modernize their customer service abilities by providing more extensive and complete information in a readily accessible format; (B) automate processes that are currently performed manually; (C) record, store, manage, and

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[5]ACCESS' obsolescence and its technical, functional, and other deficiencies are discussed at pages 15 - 25 and Exhibit A of the Joint Application.

In January 2001, HECO commissioned Bass & Company Management Consultants, LLC ("Bass Consultants") to lead the CIS Project Team to review ACCESS' ability to meet the Utilities' current and future business needs and expectations. The CIS Project Team's findings and recommendations are set forth in the *Customer Information System Assessment and Recommendation Report*, completed by Bass Consultants in 2003 (the "CIS Study"). The CIS Study is attached as Exhibit A to the Joint Application.

[6]Examples identified by Applicants include: (1) automation of time of use billing; (2) increased tracking and management of service orders, customer web access, bill print options, and customer information storage; and (3) reduction of risk in customer receivables. Applicants' responses to CA-IR-8, CA-SIR-2, and CA-SIR-3.

access customer data more effectively; and (D) more easily integrate the new CIS with other new systems.

5. From a technological perspective, the CIS will be based on current industry standard platforms, including the operating system, programming languages, relational databases, end-user interfaces, and hardware. These changes will immediately improve the functionality and usability of the new system, enabling the Utilities to provide a far more user friendly CIS to its users.

6. After identifying the technical and functional requirements of a CIS capable of meeting Applicants' current and future business needs and expectations, Applicants evaluated four (4) options: (A) outsourcing their CIS to a third-party provider; (B) developing a new CIS using custom developed, proprietary software; (C) making significant modifications to ACCESS; or (D) replacing ACCESS with a commercially available pre-packaged CIS solution ("Option 4").[7] The CIS Project Team and Utilities, following their evaluation and comparison of each option, selected Option 4:

> In summary, the [Utilities] chose [Option] 4 because it provided [them] a complete CIS solution at a reasonable cost and within a reasonable timeframe. As a result of the assessment effort, the CIS Project Team concluded that the replacement of ACCESS with a new pre-packaged CIS system would be the prudent business decision. It was considered the best combination of balancing risk and cost and technically sound solutions to the problems identified during the research process. A new CIS package should fully address

[7]The four (4) Options are described in detail at pages 26 - 35 of the Joint Application.

> current ACCESS limitations and resolve the majority of business requirements identified. While cost was a significant consideration in making this recommendation, it was not the sole consideration. Other strategic issues ultimately led the team to this conclusion. In particular, the [CIS Project] Team determined that modification of ACCESS will not sufficiently meet [the Utilities'] critical current needs, has an extremely long lead-time, and is subject to many implementation risks. These issues as well as others are identified and while not all quantifiable, are critical to the near and long-term success of any CIS option.[8]

7. While Applicants have not quantified any cost savings associated with the new CIS, efforts to replace CIS systems in the utility industry are generally not undertaken to deliver cost savings, but rather, to meet needs that are not supported by the current systems. "These needs include providing new system functionality necessary to support customer or marketplace requirements or to mitigate the risk of technology obsolescence and system failure."[9] Thus, in the absence of specific cost savings directly attributable to the new CIS, a return on investment calculation is difficult to measure.

8. It is prudent business practice to plan and implement the replacement system now, and: (A) not expend additional time and resources to modify and maintain the current, outdated system; and (B) avoid the current system's possible failure.

In summary, Applicants emphasize and reiterate that the key factor driving the CIS Project is ACCESS' technical and

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[8]Joint Application, at 33 - 34 (quoting the CIS Study, at 6 - 7).

[9]Applicants' response to CA-IR-5(a).

functional deficiencies. The underlying issue, in Applicants' view, is not whether ACCESS needs to replaced, but when.

V.

Strategic Technology Systems Initiative

Applicants explain that the CIS Project is part of HECO's strategic technology systems initiative. Specifically, HECO is pursuing four (4) strategic technology systems initiatives that, when combined, will share information and enhance HECO's reliability, performance, and customer service. The four (4) initiatives are:

1. HECO's Business Telecommunications Systems and Network Replacement Project, approved by the commission in Docket No. 03-0124 (Decision and Order No. 20407, filed on August 29, 2003);

2. HECO's Energy Management System Replacement Project, approved by the commission in Docket No. 03-0360 (Decision and Order No. 21224, filed on August 6, 2004);

3. HECO's Outage Management System Implementation Project, currently pending before the commission in Docket No. 04-0131; and

4. The CIS Project (Docket No. 04-0268), with an estimated completion date of twenty-four (24) months.[10]

[10]Applicants: (1) developed and distributed a Request for Quotes to more than twenty (20) CIS vendors; (2) are in the process of developing a formal Request for Proposal ("RFP"); and (3) upon the commission's approval of the Application, intend to finalize and issue the RFP, and select a CIS vendor.

The new CIS, Applicants explain: (1) will be fully integrated with the Outage Management System (Docket No. 04-0131) and the Interactive Voice Response/Computer Telephony Integration component of the telecommunications system (Docket No. 03-0124); and (2) will not be integrated with the Energy Management System (Docket No. 03-0360). Moreover, by integrating the CIS with the Outage Management System and telecommunications system, expected system efficiencies will include: (1) receiving updated information from the dispatch/systems operations center; (2) updating outage information to the interactive voice response system; and (3) the availability of customer service representatives during outages.

VI.

Accounting Treatment

A.

GAAP

The Utilities state that their proposed accounting treatment of the Project's costs is consistent with generally accepted accounting principles ("GAAP"). The Utilities specifically cite to: (1) Statement of Position 98-1, *Accounting for the Costs of the Computer Software Developed or Obtained for Internal Use*, issued by the American Institute of Certified Public Accountants, Inc., Financial Accounting Standards Board ("FASB"), in March 1998 ("SOP 98-1");[11] and (2) FASB's

[11]Exhibit E, at 1, of the Joint Application.

Statement 34, *Capitalization of Interest Cost*, dated October 1999 ("Statement 34").[12]

The Consumer Advocate, in addition to SOP 98-1 and FASB's Statement 34, refers to FASB's Emerging Issues Task Force Bulletin 97-13, *Accounting for Costs Incurred in Connection with a Consulting Contract or an Internal Project That Combines Business Process Reengineering and Information Technology Transformation*, dated March 1999 ("EITF 97-13").[13]

SOP 98-1, Statement 34, and EITF 97-13 are part of the docket record.[14]

B.

Applicants' Proposed Accounting Treatment

The total estimated cost of the CIS Project is $20,349,558.[15] This amount, Applicants state: (1) "represents the estimated cost to acquire and implement a new CIS[;]"[16] and

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[12]See Applicants' response to CA-SIR-25(b). See also CA's SOP, Section VI(C).

[13]CA-IR-18, CA-SIR-23, and CA's SOP, Section VI.

[14]Applicants' responses to PUC-IR-101, PUC-IR-201, and PUC-IR-301.

[15]Applicants' correspondence, dated December 13, 2004, at 1 and Revised Table 1, "Summary Costs by Accounting Stages," attached thereto.

[16]Applicants' response to CA-IR-17(a).

(2) reflects the cost of a system that meets the Utilities' current and near-term technical and functional needs.[17]

Based on the costs directly incurred by and allocated to each of the Utilities, the estimated cost of the CIS Project is $14,142,000 for HECO, $3,172,000 for HELCO, and $3,035,000 for MECO.

The Utilities' proposed accounting treatment of the Project's costs is set forth in Exhibit E, as amended, of the Joint Application, and consists of three (3) stages: (A) Stage 1, Preliminary; (B) Stage 2, Application Development/Installation; and (C) Stage 3, Post-Implementation/Operation.[18]

In general, the Utilities propose to capitalize computer hardware costs and related AFUDC, and either expense or defer (with related AFUDC) and amortize software costs, depending

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[17]The Project's total estimated cost, therefore, does not include the costs for anything beyond Applicants' current and near-term technical and functional needs.

That said, Applicants state that their objective "is to select a system and vendor that meets current and near-term needs but also provides long-term support and an upgrade path that allows the [Utilities] to support unanticipated long-term needs through additional modules or customization." Applicants' response to CA-SIR-12(c). Thus, in the event Applicants later "decide to implement functions that require additional modules or customization, by selecting a system and vendor that offers integrated modules, [Applicants] will minimize costs typically incurred when implementing and integrating systems provided by different vendors." Id.

[18]A copy of Applicants' Revised Table 1, "Summary Costs by Accounting Stages," is attached to this Decision and Order. See also Exhibit G of the Joint Application, "CIS Replacement Project: Totals by Project Phase, Company, Indicator & Cost Type." (On December 13, 2004, Applicants submitted a revised version of Exhibit G under confidential seal.)

on the type of work performed during each stage of the Project. Thus, the Utilities specifically propose to:

1. Expense the Stage 1 costs;

2. Capitalize, defer and amortize, or expense, the Stage 2 costs;

3. Expense the Stage 3 costs;[19]

4. Accumulate AFUDC during the Stage 2 deferral period;

5. Amortize the deferred costs, including AFUDC, over a ten (10)-year period (based on the estimated useful service life of the CIS), or such other amortization period the commission finds reasonable, commencing the month after Stage 2 is completed; and

6. Include the unamortized deferred costs, including AFUDC, in rate base.

In addition, the Utilities explain that "[t]he accounting treatment for capital costs (e.g. hardware costs) will follow existing practices."[20]

With respect to AFUDC:

> [T]he [Utilities] have not begun accruing AFUDC for the CIS Project. AFUDC will begin to accrue when the [Utilities] incur capital or deferred costs, following PUC approval. Accrual of AFUDC on capital costs will begin when hardware is purchased for the new CIS, estimated for March 2005. Accrual of AFUDC on deferred costs will begin when work is performed to prepare for the

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[19]For the specific cost breakdown, see Revised Table 1 of Applicants' Exhibit E, attached. See also Exhibit G of the Joint Application.

[20]Exhibit E, at 2, of the Joint Application.

CIS hardware and software installation, also estimated for March 2005.[21]

VII.

Consumer Advocate's Position

The Consumer Advocate focused its review on: (1) whether a need exists to address technical deficiencies in ACCESS, the Utilities' existing customer information system (CA's SOP, Sections II and III); (2) if so, is it reasonable to purchase a new CIS (CA's SOP, Section V(A) - (C)); (3) ascertaining, at this time, the reasonableness of the CIS costs (CA's SOP, Section V(D)); and (4) whether the commission should approve the recovery of the CIS costs using the Utilities' proposed accounting procedures (CA's SOP, Section VI).[22]

The Consumer Advocate, in sum, concludes that:

1. The Utilities should be allowed to address ACCESS' technical deficiencies by purchasing a new CIS.

2. To the extent that the costs of a new CIS: (A) are not associated with business process re-engineering efforts, the costs can be deferred in accordance with accounting guidelines

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[21]Utilities' response to CA-IR-21(a). As an update, the commission notes that the Utilities have not begun to accrue AFUDC for the CIS Project.

[22]The Consumer Advocate also raises two (2) other matters, and notes that: (1) various cost adjustments are necessary for future rate case proceedings based on the accounting treatment approved by this Decision and Order, in order to avoid the potential for "double recovery" by the Utilities; and (2) the Utilities, in response to CA-IR-26(b)(2), outline their current security measures that protect against unauthorized internal and external access to customer data. CA's SOP, Section VII.

and amortized over a future time period (i.e., twelve (12) years), with the unamortized costs included in rate base; and (B) are properly deferred in accordance with GAAP, AFUDC can be accrued.

3. Nonetheless, the level of costs to be deferred and the amount of AFUDC to be accrued are areas of concern.

A.

Technical Deficiencies

While Applicants have not explicitly requested the commission's approval to commit funds for the Project as part of a capital expenditure application, "the Consumer Advocate asserts that a determination must first be made as to whether the existing CIS is in need of replacement."[23]

The Consumer Advocate, following its review of Bass Consultants' CIS Study and the various alternatives considered by the Utilities: (1) concurs that a need exists to address the technical deficiencies associated with ACCESS; and (2) does not object to the Utilities' decision to purchase a new pre-packaged CIS. This position, the Consumer Advocate notes, "is conditioned on the understanding that the [Utilities] will be held accountable for ensuring that customers receive discrete and measurable benefits from the purchase and installation of a new pre-packaged CIS."[24]

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[23]Consumer Advocate's SOP, at 4 - 5.

[24]Id. at 9.

B.

Purchasing a New CIS

1.

Concerns

The Consumer Advocate expresses its concerns with Applicants' proposal to purchase a new pre-packaged CIS, noting that:

1. The CIS Project is expected to require two (2) years to complete and will cost $20,350,000 (current estimate).

2. The CIS Project is one (1) of four (4) major information technology ("IT") projects that HECO plans to install in the near future. See Section V, above. The total cost of all four (4) projects is expected to exceed $53 million.

3. For the other three (3) projects, the Consumer Advocate expressed concerns over the possibility of significant cost overruns. The same concern exists with the CIS Project.

4. Ratepayers may end up paying for an IT project that does not provide the expected benefits.[25] In this respect, the Consumer Advocate's independent research reveals "the difficulties and disappointments experienced by utility companies attempting to implement a new CIS."[26]

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[25]The Consumer Advocate cites two (2) examples: (1) HECO's work force management system; and (2) HECO's retired distribution SCADA system.

[26]CA's SOP, at 13. The Consumer Advocate specifically quotes an excerpt from energyCRM.com.

2.

Recommendations

The Consumer Advocate asserts that Applicants do not identify specific criteria, goals, benchmarks, or performance targets by which to assess the objectives and benefits of the new CIS, nor do Applicants quantify the estimated cost savings resulting from the new CIS. In essence, "[w]ithout sufficient justification, the Consumer Advocate is concerned that, rather than streamlining existing processes, the new CIS might be used to justify inefficiencies or extraneous tasks that will not provide concrete benefits to customers."[27]

In response, the Consumer Advocate urges that clear, specific criteria or benchmarks be established at the onset, "in order to develop a CIS that will meet the [Utilities'] needs and/or objectives and measure the cost effectiveness of the system."[28] To demonstrate clear and tangible benefits to Applicants' ratepayers, and to require accountability of the new CIS, the Consumer Advocate recommends that, at a minimum, the Utilities:

1. Identify target performance levels for each of the objectives established for the new CIS.

2. Evaluate the current measures of operational performance for the CIS and determine whether target performance levels should be revised and whether additional measures should be implemented for the new CIS. The evaluation of all current

[27]CA's SOP, at 18.

[28]Id. at 13.

and proposed target performance measures and any revisions or additions thereto should be submitted to the commission and Consumer Advocate within twelve (12) months following the commission's issuance of this Decision and Order.

3. Evaluate the existing processes and evaluate and quantify the possible labor and non-labor savings that might be caused by replacing ACCESS with a new CIS.

4. File annual reports measuring actual performance, as compared to the target performance measures.

The Consumer Advocate's recommended conditions, it asserts, are meant to take advantage of the capabilities of the new CIS, once installed.[29]

C.

<u>Project's Estimated Cost</u>

The Consumer Advocate notes that the Project's estimated cost is subject to future adjustment for various reasons.[30] Accordingly, it is impossible to ascertain whether the current estimated cost is reasonable. Nonetheless, to assist the commission and Consumer Advocate in their future review of the

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[29]The Consumer Advocate also recommends that, as part of this proceeding, the commission evaluate, identify, and measure the Utilities' service quality standards.

[30]Specifically, the Consumer Advocate observes that: (1) the Utilities have yet to receive bids and select the vendor for the new CIS; (2) the Project's current estimated cost may not include the costs for all functions and activities needed to complete the installation, such as system integration costs; and (3) the cost of the new CIS may include "nice to have" functions, such as marketing features, that are not required for the provision of safe and reliable electric service.

Project's actual costs, the Consumer Advocate recommends that the Utilities:

1. Within thirty (30) days of the selection of the vendor, file an interim report identifying the contractor selected; bid amount awarded (Project's cost); Project's scope; and functional requirements.

2. File written notification whenever there is a significant change in either the functionality or cost of the Project.[31]

In addition, in distinguishing between current or near-term functional requirements and "nice to have" functions, the Consumer Advocate firmly asserts that ratepayers should not be required to pay for the latter functions. In this respect, the Consumer Advocate represents that the Utilities agree to:

1. Exclude the cost of any functionality that meets a two (2)-part test - i.e., the functionality in question: (A) is not the core functionality of the selected vendor's CIS program; and (B) is considered "nice to have" by the Utilities, as opposed to "need to have."

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[31]As the Consumer Advocate explains:

> The measurement of such a change would be based on a 'gap' analysis that would be conducted by the [Utilities] following the award of the contract. The term 'significant' would generally reflect an increase or decrease in functionality beyond the functionality identified as a result of the gap analysis or an increase or decrease in [the] CIS' projected cost of over five percent (5%).

CA's SOP, at 25 (footnote and text therein omitted).

2. Identify in the Utilities' interim report any optional, "nice to have" functionality that is part of the selected vendor's base CIS program.

3. If requested, include the cost of the optional functionalities in the interim report.

The Consumer Advocate concludes that, "[d]epending on the results of the two-pronged test, . . . such 'nice-to-have' functionalities that are not part of the core system will not be included in the amount to be recovered from ratepayers."[32]

D.

Accounting Treatment

At the outset, the Consumer Advocate notes that:

1. The Utilities: (A) seek to defer the recognition of certain CIS Project costs and accumulate the costs over the period in which the CIS is being purchased and installed, rather than expense the costs in the period in which such costs are incurred; and (B) intend to then amortize the deferred accumulated CIS costs over a ten (10)-year period.

2. While the Utilities' proposed accounting treatment is generally in accord with SOP 98-1, the commission is not necessarily bound by SOP 98-1. Thus, "[i]f the Commission finds that certain costs should not be recovered from the [Utilities'] ratepayers or that the accounting treatment set forth in SOP 98-1

[32] Id. at 27.

is not appropriate, the Commission may deny the [Utilities'] request."[33]

The Consumer Advocate, in response to the Utilities' proposed accounting treatment, finds that:

1. EITF 97-13 requires the cost of business process reengineering activities, whether done internally or by third-parties, to be expensed as incurred.[34]

2. Contrary to the Utilities' position, the new CIS will result in certain business process reengineering changes. Thus, the Utilities should be required to identify the business process reengineering activities that are anticipated with the installation of the new CIS, and expense the costs associated with these activities in accordance with EITF 97-13. In addition, any related costs for restructuring the Utilities' work force should also be expensed.

3. The classification of the Project's costs cannot be determined at this time, based on the present uncertainties surrounding the Project's scope and costs. Thus, it is imperative for the Utilities to maintain proper documentation with sufficient detail to support and verify the classification of costs in accordance with SOP 98-1. The Utilities will establish the appropriate work orders within the ELLIPSE Project

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[33]Id. at 28.

[34]EITF 97-13 includes two (2) types of costs associated with business process reengineering: (1) "process reengineering," defined as the effort to reengineer the entity's business process to increase efficiency and effectiveness; and (2) "restructuring the work force," defined as the effort to determine what employee make-up is necessary to operate the reengineered business processes.

Module to accumulate the CIS Project costs that are capitalized, deferred, and expensed.[35]

4. SOP 98-1 provides that interest costs incurred during the development of software projects should be capitalized in accordance with Statement 34. Thus, to the extent that the Utilities can demonstrate that the costs associated with the CIS Project have been properly accounted for as a deferred cost, the Consumer Advocate does not object to the accrual of AFUDC on those costs.

5. SOP 98-1, Paragraph 80, provides that overhead costs should be expensed as incurred. The Utilities propose to capitalize a certain amount of overhead ("On-costs") as deferred software costs. If the Utilities are allowed to defer certain software development costs, the Consumer Advocate recommends that On-costs be expensed in accordance with SOP 98-1 and tracked as necessary by the Utilities. Following the filing of the final cost report, the Utilities should maintain the data necessary to properly exclude these On-costs.

6. While the Utilities propose to amortize the deferred CIS costs over a ten (10)-year period based on the system's estimated useful service life, under the new depreciated rates for HECO recently approved by the commission, the depreciation rate for communication equipment (account number 397.00) is 5.94 and the average service life is

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[35]Applicants' response to CA-IR-19.

twelve (12) years.[36] Unless the Utilities can provide documentation that will support a service life shorter than twelve (12) years, the amortization for both the capital and deferred costs should be twelve (12) years.

The Consumer Advocate represents that:

1. The Utilities are willing to conform with GAAP.

2. The appropriate procedures will be implemented to identify reengineering costs.

3. Any costs identified as reengineering will be expensed and not deferred.

4. Within sixty (60) days of the commercial operation of the new CIS, the Utilities will file a final cost report that provides the appropriate work orders identifying the amounts of CIS costs capitalized, deferred, or expensed, along with supporting summary documentation.

5. With respect to the Consumer Advocate's belief that the Utilities' On-costs should be expensed as incurred, "the [Utilities] are willing to conform to the guidance set forth in SOP 98-1."[37]

6. The Utilities do not object to amortizing the CIS hardware and software costs over a twelve (12)-year period, while asserting that ten (10) years is the expected useful service life.

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[36] See Decision and Order No. 21331, filed on September 3, 2004, in Docket No. 02-0391, Attachment B, at 1, and Attachment E, at 1.

[37] CA's SOP, at 34.

E.

Conclusion

The Consumer Advocate's overall position, it emphasizes, is "predicated upon the understanding that it reserves the right to address the reasonableness of including future costs associated with the proposed CIS in each company's rate base and the appropriate level that should be recognized until all supporting documentation have been reviewed."[38]

VIII.

Parties' Joint Letter

A.

Preamble

The Parties state that:

1. The agreements in their joint letter "are for the purpose of simplifying and expediting this proceeding, and represent a negotiated compromise of the matters agreed upon, and the consequences of such agreements shall be limited to the matters agreed to herein."[39]

2. The Parties "expressly reserve their right to take different positions regarding the matters agreed to herein in other proceedings."[40]

3. With the filing of their joint letter, this proceeding is ready for decision-making by the commission.

The commission, as part of its mandate under HRS chapter 269, reviews the justness and reasonableness of the

[38]Id. at 38.

[39]Parties' joint letter, at 1.

[40]Id.

Parties' mutual conditions and agreements thereto, as reflected in their joint letter.

B.

Mutual Conditions

The Parties agree to nine (9) conditions in response to the Consumer Advocate's overall concerns, set forth in their joint letter, as follows:

1. Within twelve (12) months following the completion of the Project's bid process, the Utilities agree to notify the commission and Consumer Advocate of the performance and quality of service measures that are produced automatically by the new CIS.[41] The Parties' intent is to have the Utilities provide a list of the data gathering and reporting functions that are available in the new CIS that can be automatically tracked and reported.

Upon such notification, the Parties will meet to discuss the possibility of tracking and reporting relevant quality of service measurements, on a forward looking basis, that are automatically produced by the CIS. At the conclusion of their discussions, the Utilities will notify the commission and Consumer Advocate of the performance and quality of service measures the Utilities will track on a going forward basis after the Project is placed into service.

[41]The Parties define the completion of the Project's bid process as the period when the contract has been entered into between the Utilities and contractor.

Presently, the Utilities agree to report, on an annual basis, the following five (5) performance measures:

A. *Same Day Billing*: the measurement of the number of bills produced as compared to the number of valid meter readings received by the CIS expressed in the form of a percentage calculated on an annual basis.

B. *Bills per Billing Representative*: expressed as a ratio of the total bills produced per year, divided by total billing department staffing.

C. *Bills per Customer*: expressed as a ratio of the total number of printed and reprinted bills produced in a year, divided by total customers.

D. *Credit Arrangements*: expressed as the average number of credit arrangements per customer who requested arrangements per year.

E. *Billing Accuracy*: the total bills produced minus the number of cancel/rebills, divided by the total bills produced that will be expressed in the form of a percentage calculated on an annual basis.

2. The Utilities will track the five (5) performance measures set forth in the first condition, as well as any relevant service quality measures as agreed to by the Utilities in the first condition, on a forward looking basis, once the Project is implemented. In addition, the Utilities will set a performance target for the measurement of *Same Day Billing* such that the *Same Day Billing* measurement can be compared to the targeted performance level.

3. Within thirty (30) days after the completion of the Project's bid process, the Utilities will submit an interim supplemental report that contains the name of the contractor selected, the scope, functional requirements, and Project's cost.[42] This filing is not intended to result in any immediate regulatory action.

4. The Utilities will not include in the Project's costs any functionality that meets the following two (2)-part test: (A) the functionality in question is not in the "core functionality" of the selected vendor's CIS program; and (B) the functionality in question is considered "nice to have" by the Utilities, in contrast with "need to have." The Utilities consider the functionality that meets this two (2)-part test to be an "optional functionality," as opposed to "core functionality."

Any optional functionality to the selected vendor's base CIS program that is not considered "need to have" by the Utilities will be identified in the interim supplemental report.[43] The selected CIS program may have functionality that might be considered to be "nice to have" by the Utilities but which is part of the base CIS program, and such "nice to have"

[42]The Utilities intend to submit this information to the commission and Consumer Advocate under confidential seal, pursuant to Protective Order No. 21444, filed on November 4, 2004.

[43]The Parties state that the base CIS program means that the functionality cannot be removed without additional cost to the program price.

functionality cannot be economically or technologically removed from the base CIS program.

In addition: (1) some of the necessary functionality for the Utilities may not be in the vendor's base CIS program, but is an option to the base CIS program as the "core functionality" varies from vendor to vendor;[44] and (2) if requested by the Consumer Advocate, the Utilities agree to include in their interim supplemental report the cost of optional functionality as defined in this Condition No. 4.

5. The Utilities will file notification letters with the commission and Consumer Advocate, if and when there is a significant change in either the functionality or cost of the Project, from the baseline functionality or cost resulting from the gap analysis, which will be conducted by the Utilities following the awarding of the contract.[45] The term "significant," as used in this paragraph, is defined as an increase or decrease in functionality beyond the functionality identified as a result of the gap analysis or an increase or decrease in the Project's

[44]In other words, there is no uniformity among vendors as to what is considered a CIS' core functionality.

[45]Specifically, the Utilities will conduct a gap analysis that identifies the changes that need to be made in the CIS, either through configuration or modification to the code, in order for the system to fully support the Utilities' requirements. The gap analysis: (1) is a complete, end-to-end evaluation of the CIS system: (2) is expected to take approximately four (4) months to complete following the awarding of the contract; and (3) will give the Utilities a more complete estimate of the cost and functionality of the Project.

projected costs (as stated in the Application or most recent estimate) of over five (5) per cent. This filing is not intended to result in any immediate regulatory action.

6. The Utilities' accounting treatment of the Project will be in conformance with GAAP, including SOP 98-1 and EITF 97-13. Accordingly:

A. The Utilities will work with the Consumer Advocate to identify costs related to process reengineering after the gap analysis between the CIS software package and the current customer billing process is completed. The significance of identifying reengineering costs incurred as a result of the new CIS is that these costs will be expensed.

B. Certain overhead costs, currently estimated at approximately $211,000, relating to customer installations and corporate administration, are currently included in the deferred costs as the current Ellipse system includes such costs as part of the normal overhead calculation process. Overhead costs will be expensed in accordance with SOP 98-1, and the Utilities will identify and track the overhead costs and reclassify the costs each month, as appropriate.

7. Within sixty (60) days of commencement of commercial operation of the CIS, the Utilities shall file a cost report that provides the appropriate work orders that state whether the CIS costs were capitalized, deferred, or expensed, along with summary supporting documentation. In general, to the extent that costs are properly classified as capital/deferred

costs, the Consumer Advocate does not object to the accrual of AFUDC on those costs.

8. While the Utilities estimated that the expected useful service life of the Project is ten (10) years, the Utilities do not object to, and will amortize the Project over a twelve (12)-year period.

9. The Utilities acknowledge that the Consumer Advocate reserves the right to address the reasonableness of the amount of the Project costs deferred and included in each Utility's rate base, pending a review of the final cost report submitted for the Project. Further, "any issues with the amount of Project costs to be included in rate base for ratemaking purposes will be addressed in a rate case conducted with a test year in which or after which the component is completed and placed in service."[46]

C.

<u>Parties' Overall Agreement</u>

Subject to these nine (9) conditions, the Parties agree to allow the Utilities to:

1. Defer (i.e., capitalize) certain computer software development costs for the CIS Project.

2. Accumulate AFUDC on the deferred costs during the deferral period.

[46]Parties' joint letter, at 6.

3. Amortize the deferred costs over a twelve (12)-year period.

4. Include the unamortized deferred costs in rate base.

IX.

Docket No. 99-0207

The commission initiates its review with a discussion of Docket No. 99-0207, HELCO's 2000 test year rate case, which the Utilities cite to as the underlying basis for its Application.

On January 1, 1999, the Utilities completed and implemented APPRISE, a computer software development project designed to produce improved business processes and procedures for the Utilities, utilizing an integrated business software program. The Utilities: (1) deferred and amortized the system development costs incurred between 1997 to 1999, over a five (5)-year period, beginning January 1, 1999; and (2) included the test year balance of unamortized APPRISE costs in HELCO's rate base.

HELCO, in Docket No. 99-0207, sought to recover the deferred system development costs and unamortized balance as part of its 2000 test year rate case.

The commission held that HELCO did not meet its burden of justifying the inclusion of the costs for APPRISE in its 2000 test year revenue requirement.[47] The commission: (1) distinguished HELCO's request with three (3) other commission decisions;[48] and (2) reasoned that the costs for APPRISE were last incurred in 1999, outside of the 2000 test year. Accordingly, the commission disallowed from expenses and rate base the costs associated with APPRISE.

The commission finds that the facts and circumstances in Docket No. 04-0268 involving the CIS Project differ from APPRISE in Docket No. 99-0207. Most notably: (1) in Docket No. 04-0268, the Utilities' request to engage in certain

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[47]Decision and Order No. 18365, filed on February 8, 2001, at Section V(B), in Docket No. 99-0207, *In re Hawaii Elec. Light Co., Inc.*

[48]HELCO cited to three (3) HECO rate case decisions (Dockets Nos. 6531, 6998, and 7766) in support of its argument that the commission's past treatment of computer system development costs justified HELCO to defer its APPRISE costs, amortize the expense over five (5) years, and collect a return on the unamortized portion in rate base.

The commission noted that: (1) in Dockets Nos. 6531 and 6998, the computer system development costs authorized by the commission were clearly incurred during the respective test years; and (2) in Docket No. 7766, it accepted as reasonable the parties' agreement of its accounting treatment for three (3) separate computer systems, as part of the commission's review of the parties' stipulation, as a whole. The commission's decision in Docket No. 7766 "was clearly limited to the circumstances of that case, and reflected the parties' intent to simplify and expedite the docket through negotiations and compromise." Decision and Order No. 18365, at 14 (footnote and text therein omitted). As additional support, the commission noted that "in Kauai Electric ("KE") Division's 1995 test year rate case, the commission disallowed KE's attempt to recover certain expenses incurred in 1993." Id. at 14 - 15 (footnote and quotation therein omitted).

accounting treatment is made pursuant to GAAP and the Parties' agreement; and (2) in Docket No. 99-0207, HELCO sought deferred treatment for a project following its installation and inception.

X.

Commission's Review

The underlying issues, in the commission's view, are: (1) the merits of the CIS Project; (2) whether the Utilities' proposed accounting treatment of the Project's costs is reasonable; and (3) whether the accrual of interest for the CIS Project is appropriate.

A.

Merits of the CIS Project

The Consumer Advocate suggests that the Utilities are remiss in not explicitly seeking the commission's approval to commit the funds for the Project, noting that the costs the Utilities seek to defer exceed the $2.5 million threshold governing the filing of a capital expenditure application.[49]

The Utilities counter that a capital expenditure application for the CIS Project is not required, reasoning that:

1. The Project's computer hardware costs (and related AFUDC to be capitalized) are estimated at $631,000, well below the $2.5 million threshold.

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[49]See Section 2.3(g)2 of General Order No. 7, *Standards for Electric Utility Service* ("G.O. No. 7"), as modified by Decision and Order No. 21002, filed on May 27, 2004, in Docket No. 03-0257 (HECO, HELCO, and MECO).

2. Its request to defer certain computer software development costs is not "plant replacement, expansion or modernization," as set forth in G.O. No. 7, Section 2.3(g)2, as modified by Decision and Order No. 21002.

The Consumer Advocate does not concur with the Utilities' position. Nonetheless, it "chose[s] not to pursue the matter since the [Utilities'] Application, if approved by the Commission, would allow the [Utilities] to achieve the same end result as if the Application were filed under G.O. [No.] 7[.]"[50] Also, the Parties "agree that a decision on the amount of costs, including AFUDC, to be deferred or capitalized to **plant**, and subsequently included in rate base for ratemaking purposes will be decided in the rate case with a test year in which or after which the Project is completed and placed in service."[51]

The commission notes that, with respect to capital expenditure applications filed by electric utilities:

> 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.'[52]

[50]Parties' joint letter, at 2, footnote 3.

[51]Id. (emphasis added).

[52]Decision and Order No. 21002, at 12. See also Decision and Order No. 21001, filed on May 27, 2004, at 12, in Docket No. 03-0256 (Kauai Island Utility Cooperative).

The Parties agree to defer to future HECO, HELCO, and MECO rate cases any decision on the amount of costs, including AFUDC, to be deferred or capitalized to plant-in-service, for subsequent inclusion in rate base, after the Project is completed and placed into service. Moreover, AFUDC, by definition, applies to a utility's plant under construction:

> When utilities are not allowed to earn a return to cover their construction financing costs during the construction period, they are allowed to capitalize the financing costs for future recovery through an allowance for funds used during construction (AFUDC). This capitalized cost, which is added to the basis of utility plant under construction, will ultimately be included in the rate base as a component of plant in service, thereby earning a return and being recovered through depreciation allowances. Although the actual mechanics of computing AFUDC may be challenged, there is little debate over the propriety of including AFUDC as a component of construction costs along with materials, labor, overhead, and the like. . . .[53]

The Utilities seek permission to defer (i.e., capitalize) certain computer software developments, accumulate AFUDC on the deferred costs during the deferral period, and include the unamortized deferred costs (including AFUDC) in rate base. The commission finds that, under these circumstances, it is prudent for the Utilities to make a specific request for approval to commit the funds to the CIS Project.[54]

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[53]R. Hahne, G. Aliff, and Deloitte & Touche LLP, *Accounting for Public Utilities*, § 4.04(4), at 4-16 (2004).

[54]HECO filed capital expenditure applications for the Business Telecommunications Systems and Network Replacement Project (Docket No. 03-0124) and Energy Management System Replacement Project (Docket No. 03-0360), respectively, which are two (2) of the strategic technology systems initiatives HECO is currently pursuing. <u>See</u> Section V of this Decision and Order.

The Utilities' Application, supporting exhibits, and their responses to the Consumer Advocate's information requests, discuss the purported merits of the CIS Project. In addition, the Consumer Advocate, as part of its investigation, extensively reviewed the Utilities' asserted need for the CIS Project. The Consumer Advocate, moreover, concludes that the Utilities' Application "achieve[s] the same end result as if the Application were filed" in accordance with the commission's procedures governing capital expenditure applications.[55] The Parties' first and second conditions, governing performance and quality of service measures, are also in direct response to the functions of the CIS Project.

We agree that if this Application is approved by the commission, it would achieve virtually the same end result as if the Application were filed under G.O. No. 7. Accordingly, the commission need not decide in this instance whether the Utilities must file an application for approval of a capital expenditure project under G.O. No. 7.

B.

Accounting Treatment and Interest

In general, the Utilities propose to capitalize computer hardware costs and related AFUDC, and either expense or defer (with related AFUDC) and amortize software costs, depending on the type of work performed during each stage of the Project

[55] Parties' joint letter, at 2, footnote 3.

(Stages 1, 2, and 3).[56] The Parties stipulate that for the Project's Stage 2 costs (i.e., the Application Development Stage), the Utilities should be allowed to: (1) defer certain computer software costs; (2) accumulate AFUDC on the deferred costs during the deferral period; (3) amortize the deferred costs over twelve (12) years; and (4) include the unamortized deferred costs in rate base.

The commission has thoroughly reviewed SOP 98-1, Statement 34, and EITF 97-13.

In general, SOP 98-1 provides that:

1. Development costs that contribute directly to the final software product are capitalized, while costs that do not contribute directly to the final software product are expensed.[57]

2. Once the entity determines how the software development work will be conducted, the entity enters Stage 2, at which point the costs incurred to develop or obtain computer software for internal use must be capitalized and accounted for as a long-lived asset.

3. The costs of computer software developed or obtained for internal use are amortized on a straight-line basis,

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[56]See Applicants' Revised Table 1, "Summary Costs by Accounting Stages," attached to this Decision and Order.

[57]Examples of non-direct costs include overhead costs. SOP 98-1, Paragraph 80, states that overhead costs are expensed as incurred. The Parties' Condition No. 6(B) incorporates Paragraph 80's directive. Condition No. 6(B) provides in part that overhead costs will be expensed in accordance with SOP 98-1, and the Utilities will identify and track the overhead costs and reclassify the costs each month, as appropriate.

and the amortization commences when the computer software is ready for its intended use.[58]

4. Interest costs incurred while developing internal use computer software are capitalized in accordance with Statement 34.[59]

For EITF 97-13, the EITF notes that: (1) in today's business environment, it is common for entities to enter into consulting contracts that combine business process reengineering and IT transformation; and (2) such consulting contracts may include software development, acquisition, and implementation, training, and on-going support in addition to the business process reengineering.

That said, EITF 97-13: (1) defines process engineering as "the effort to reengineer the entity's business process to increase efficiency and effectiveness[;]"[60] and (2) concludes that the cost of business process reengineering activities, whether done internally or by third-parties, is expensed as incurred, regardless of whether the business process reengineering is undertaken as a separate project or as part of a larger project

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[58]The Utilities, as part of Condition No. 8, accepts the Consumer Advocate's recommendation to amortize the Project over twelve (12) years, consistent with Decision and Order No. 21331 in Docket No. 02-0391 (HECO's deprecation rates docket).

[59]The Parties, in their Condition No. 7, agree that, "[i]n general, to the extent that costs are properly classified as capital/deferred costs, the Consumer Advocate does not object to the accrual of AFUDC on those costs." Parties' joint letter, at 6.

[60]See Applicants' response to PUC-IR-201, at 3.

that includes software development. The Parties' Condition No. 6(A) incorporates EITF 97-13's directive.[61]

C.

Findings and Conclusions

The Parties' mutual conditions respond to the Consumer Advocate's overall concerns regarding: (1) the need for a new CIS; (2) the Project's present estimated cost; and (3) the Utilities' proposed accounting treatment of the Project's costs. The nine (9) agreed-upon conditions, moreover, incorporate and expand upon the Consumer Advocate's recommendations. The commission finds reasonable, and accordingly adopts, the Parties' nine (9) conditions.

The Utilities' present customer information system, ACCESS, implemented in 1991, is dated. The CIS Project, once completed, is intended to integrate with HECO's Outage Management System and the Interactive Voice Response/Computer Telephony

[61]Condition No. 6(A) states that: (1) the Utilities will work with the Consumer Advocate to identify costs related to process engineering after the gap analysis between the CIS software package and the current customer billing process is completed; and (2) the significance of identifying reengineering costs incurred as a result of the new CIS is that these costs will be expensed.

Integration component of HECO's telecommunications system, thereby increasing the Utilities' system efficiencies.[62]

The commission recognizes that, while the overall benefits of the CIS Project appear difficult to quantify in terms of relative cost savings, the Utilities are responsible for tracking and maintaining data on their performance and quality of service measures once the CIS is placed into service (Conditions No. 1 and 2).

After the Project's bid process is completed, the Utilities will inform the commission and Consumer Advocate of the contractor selected, scope, functional requirements, and costs of the Project (Condition No. 3). The Project's overall cost, moreover, will not include the costs of any non-core functions (Condition No. 4), and the Utilities will promptly notify the commission and Consumer Advocate of any significant change in either the functionality or cost of the CIS Project (Condition No. 5).

In essence, the CIS Project represents an increase in productivity and efficiency, to the Utilities' and ratepayers'

[62]Provided the commission approves HECO's Outage Management System in Docket No. 04-0131. On April 21, 2005, HECO and the Consumer Advocate filed a joint letter for the commission's review and action. The commission intends to undertake an independent review and analysis of HECO's proposed Outage Management System Project in Docket No. 04-0131. Accordingly, the commission's analysis and disposition of the CIS Project, as reflected in this Decision and Order, solely applies to Docket No. 04-0268.

mutual benefit. Based on the Utilities' representations, the commission finds that the CIS Project is reasonable and viable.[63]

With respect to the Utilities' specific requests, the commission begins with the precept that accounting principles for regulated utilities often deviate from GAAP, and the commission is not required to follow GAAP.[64]

That said, the commission finds that the Utilities' proposed accounting treatment of the Project's costs is: (1) consistent with GAAP and the Parties' agreement; and (2) reasonable under the present facts and circumstances. To the extent the Utilities are currently unable to classify the costs due to the non-selection of the Project vendor, the Utilities agree to file a cost report within sixty (60) days of the CIS' commercial operation, "that provides the appropriate work orders that state whether the CIS costs were capitalized, deferred or expensed, along with summary supporting documentation."[65]

The commission approves the Utilities' request to defer certain computer software development costs, accumulate AFUDC on the deferred costs during the deferral period, amortize the deferred costs over a twelve (12)-year period, and include the unamortized deferred costs in rate base; subject to the

[63]A closer scrutiny of the Project's costs, however, is reserved: (1) until the Utilities complete the Project and file their cost report (Condition No. 7); and (2) for the future rate cases of HECO, HELCO, and MECO, respectively (Condition No. 9).

[64]See FASB's Statement No. 71, *Accounting for the Effects of Certain Types of Regulation*, dated December 1982, as amended.

[65]Parties' joint letter, at 6, Condition No. 7.

commission's adoption of the Parties' nine (9) conditions, as discussed herein.

XI.

Orders

THE COMMISSION ORDERS:

1. The Utilities' request to expend approximately $20,350,000 for the CIS Project is approved; provided that no part of the Project may be included in the Utilities' rate bases unless and until the Project is in fact installed, and is used and useful for public utility purposes.

2. The Utilities' request to defer certain computer software development costs, accumulate AFUDC on the deferred costs during the deferral period, amortize the deferred costs over a twelve (12)-year period, and include the unamortized deferred costs in rate base, are approved; subject to the commission's adoption of the Parties' nine (9) conditions set forth in Section VIII(B) of this Decision and Order, and incorporated herein by reference.

3. As part of said conditions and unless otherwise ordered, the Utilities shall file the following reports or information with the commission, with copies served upon the Consumer Advocate:

A. Within twelve (12) months following the completion of the Project's bid process, information on the performance and quality of service measures that are produced automatically by the new CIS. Condition No. 1.

B. Within sixty (60) days following the conclusion of the Parties' discussions, information on the performance and quality of service measures the Utilities will track on a going forward basis after the Project is placed into service. Condition No. 1.

C. By January 31st for the previous calendar year period, an annual report on the following five (5) performance measures: *Same Day Billing, Bills per Billing Representative, Bills per Customer, Credit Arrangements, and Billing Accuracy*. Condition No. 1.

D. Within thirty (30) days following the completion of the Project's bid process, an interim supplemental report that: (A) contains the name of the contractor selected, the scope, functional requirements, and Project's cost; and (B) if the Consumer Advocate requests, the cost of optional functionality as defined in the Parties' Condition No. 4. Conditions No. 3 and No. 4.

E. Prompt notification if and when there is a significant change in either the functionality or cost of the Project, as defined in the Parties' Condition No. 5. Condition No. 5.

F. Within sixty (60) days of the CIS' commercial operation, a cost report that provides the appropriate work orders that state whether the CIS costs were capitalized, deferred, or expensed, along with summary supporting documentation. Condition No. 7.

4. The cost report set forth in Ordering Paragraph No. 3(F), above, shall include an explanation of any deviation of ten (10) per cent or more in the Project's cost from that estimated in the Application. The Utilities failure to submit this report will constitute cause to limit the cost of the Project, for ratemaking purposes, to that estimated in the Application.

5. The Utilities shall conform to the commission's orders set forth above. Any 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 MAY - 3 2005.

PUBLIC UTILITIES COMMISSION
OF THE STATE OF HAWAII

By [signature]
Carlito P. Caliboso, Chairman

By [signature]
Wayne H. Kimura, Commissioner

By [signature]
Janet E. Kawelo, Commissioner

APPROVED AS TO FORM:

[signature]
Michael Azama
Commission Counsel

04-0268.cs

Table 1

SUMMARY COSTS BY ACCOUNTING STAGES

($Thousands)

Stage	Cost Type	Company	Yr 2003	Yr 2004	Yr 2005	Yr 2006	Total
Stage 1 Pre-approval	Expense	HECO	$ 301	$ 147	$ 233	$ -	$ 681
		HELCO	$ 70	$ 35	$ 58	$ -	$ 163
		MECO	$ 62	$ 32	$ 90	$ -	$ 184
		TOTAL	$ 433	$ 214	$ 381	$ -	$ 1,029
Stage 2 Installation	Capital	HECO	$ -	$ -	$ 403	$ 30	$ 433
		HELCO	$ -	$ -	$ 97	$ 7	$ 105
		MECO	$ -	$ -	$ 86	$ 6	$ 93
		TOTAL	$ -	$ -	$ 586	$ 44	$ 630
	Deferred	HECO	$ -	$ -	$ 5,222	$ 7,041	$ 12,264
		HELCO	$ -	$ -	$ 1,161	$ 1,559	$ 2,720
		MECO	$ -	$ -	$ 1,137	$ 1,461	$ 2,599
		TOTAL	$ -	$ -	$ 7,520	$ 10,062	$ 17,582
	Expense	HECO	$ -	$ -	$ 18	$ 667	$ 686
		HELCO	$ -	$ -	$ -	$ 165	$ 165
		MECO	$ -	$ -	$ 9	$ 117	$ 126
		TOTAL	$ -	$ -	$ 27	$ 949	$ 976
	TOTAL	TOTAL	$ -	$ -	$ 8,134	$ 11,054	$ 19,188
Stage 3 Post-Installation	Expense	HECO	$ -	$ -	$ -	$ 79	$ 79
		HELCO	$ -	$ -	$ -	$ 19	$ 19
		MECO	$ -	$ -	$ -	$ 34	$ 34
		TOTAL	$ -	$ -	$ -	$ 133	$ 133
TOTAL	TOTAL	HECO	$ 301	$ 147	$ 5,876	$ 7,818	$ 14,142
		HELCO	$ 70	$ 35	$ 1,317	$ 1,750	$ 3,172
		MECO	$ 62	$ 32	$ 1,322	$ 1,619	$ 3,035
		TOTAL	$ 433	$ 214	$ 8,515	$ 11,187	$ 20,350

CERTIFICATE OF SERVICE

I hereby certify that I have this date served a copy of the foregoing Decision and Order No. 21798 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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Karen Higashi

Karen Higashi

DATED: MAY - 3 2005