

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF HAWAII

In the Matter of the Application of)
HAWAIIAN ELECTRIC COMPANY, INC.)
For Approval of Rate Increases and)
Revised Rate Schedules and Rules.)

DOCKET NO. 04-0113

ORDER NO. 24068

Filed March 4, 2008
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Karen Higashi
Chief Clerk of the Commission

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DIV. OF CONSUMER ADVOCACY
DEPT. OF COMMERCE AND
CONSUMER AFFAIRS
STATE OF HAWAII

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

Karen Higashi

In the Matter of the Application of)
HAWAIIAN ELECTRIC COMPANY, INC.)
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By this Order, in response to the exception filed on November 1, 2007 by the DEPARTMENT OF THE NAVY, ON BEHALF OF THE DEPARTMENT OF DEFENSE ("DoD") to Amended Proposed Decision and Order No. 23768, filed on October 25, 2007,¹ the commission officially adopts the interest synchronization method as the mechanism for computing interest expense in this case. Because the commission's decision herein will affect the amounts shown in the results of operation schedules attached to Amended Proposed Decision and Order No. 23768, the commission directs the parties² to submit stipulated revised results of operation schedules, within fourteen days of the date of this Order, which reflect

²The parties to this docket are HAWAIIAN ELECTRIC COMPANY, INC. ("HECO"), the DIVISION OF CONSUMER ADVOCACY, DEPARTMENT OF COMMERCE AND CONSUMER AFFAIRS ("Consumer Advocate"), an ex officio party, pursuant to Hawaii Revised Statutes ("HRS") § 269-51 and Hawaii Administrative Rules ("HAR") § 6-61-62, and DoD (collectively, "Parties").

amounts consistent with the commission's decisions in this Order and Amended Proposed Decision and Order No. 23768, for the commission's review and approval, and for subsequent incorporation into the commission's final Decision and Order in this docket. Alternatively, if the Parties are unable to agree on revised results of operation schedules, the Parties shall submit, by the same date, proposed revised schedules for the commission's consideration.

I.

Procedural Background

On November 12, 2004, HECO filed an application ("Application"), requesting approval of rate increases and revised rate schedules and rules, and for approval and/or modification of demand-side and load management programs and recovery of program costs and demand-side management ("DSM") utility incentives.³

By Order No. 21727, filed on April 8, 2005, as amended, the commission approved, with modification, the Parties' Stipulated Prehearing Order. Pursuant thereto, the Parties engaged in settlement discussions, in an attempt to resolve the issues established for this docket.

³By Order No. 21698, filed on March 16, 2005, the commission, among other things: (1) separated HECO's requests for approval and/or modification of demand-side and load management programs and recovery of program costs and DSM utility incentives (collectively referred to as the "Proposed DSM Programs") from Docket No. 04-0113; and (2) opened Docket No. 05-0069 (Energy Efficiency Docket), in which to consider the Proposed DSM Program matters.

On September 15 and 16, 2005, the commission held an evidentiary hearing on HECO's Application. On September 16, 2005, the Parties submitted a letter describing the settlement agreement reached by the Parties ("Settlement Agreement"). The Parties were able to settle all but three issues: prepaid pension asset, conservation informational advertising, and interest synchronization.

On September 19, 2005, the commission heard oral arguments relating to the probable entitlement of HECO to its interim rate increase.⁴

By Interim Decision and Order No. 22050, filed on September 27, 2005, the commission allowed HECO to increase its rates to such levels to produce, in the aggregate, \$53,288,000 in additional revenues for the 2005 test year, or a 4.36 percent increase over revenues at present rates. The commission found that, for interim purposes, pending a final decision, it was appropriate and reasonable to adopt an average depreciated rate base of \$1,109,232,000 and a rate of return on the rate base of 8.66 percent. The commission granted this interim increase, effective from September 27, 2005, until the issuance of the commission's final Decision and Order in this docket.

⁴On September 19, 2005, HECO filed its revenue requirements and accompanying workpapers. HECO labeled its first September 19, 2005 filing as its "Final Position Revenue Requirements" (hereinafter "HECO's 1st September 19 filing") and its second September 19, 2005 filing as "Final Position Revenue Requirements with Adjustment to Kalaeloa Capacity" (hereinafter "HECO's 2nd September 19 filing").

On December 2, 2005, the Parties filed their post-hearing opening briefs,⁵ and on December 19, 2005, they filed their post-hearing reply briefs.⁶

On October 22, 2007, the commission issued Proposed Decision and Order No. 23748.

On October 25, 2007, the commission issued Amended Proposed Decision and Order No. 23768, which superseded Proposed Decision and Order No. 23748. In Amended Proposed Decision and Order No. 23768, the commission approved an increase in HECO's rates to such levels as will produce, in the aggregate, \$45,741,000 in additional revenues for the 2005 calendar test year, or a 3.74 percent increase over revenues at present rates. This increase was less than the interim increase of \$53,288,000 approved by the commission in Interim Decision and Order No. 22050, based on the commission's decision in Amended Proposed Decision and Order No. 23768 that HECO's \$78,791,000 prepaid pension asset (which was included, for interim purposes, in HECO's rate base) should be excluded from HECO's rate base. In addition, the commission ruled that HECO is not required to

⁵Opening Brief of Hawaiian Electric Company, Inc. and Certificate of Service, filed on December 2, 2005 ("HECO's Opening Brief"); Consumer Advocate's Opening Brief and Certificate of Service, filed on December 2, 2005 ("Consumer Advocate's Opening Brief"); Post-Hearing Brief of the Department of Defense; Exhibits "1" to "4" and Certificate of Service, filed on December 2, 2005 ("DoD's Opening Brief").

⁶Reply Brief of Hawaiian Electric Company, Inc.; Exhibit A; and Certificate of Service, filed on December 19, 2005 ("HECO's Reply Brief"); Consumer Advocate's Reply Brief and Certificate of Service, filed on December 19, 2005; Post-Hearing Reply Brief of the Department of Defense and Certificate of Service, filed on December 19, 2005.

utilize the interest synchronization method for calculating its interest expense.

On November 1, 2007, DoD filed its Exception to the commission's decision on interest synchronization in Amended Proposed Decision and Order No. 23768. HECO and the Consumer Advocate did not file exceptions to Amended Proposed Decision and Order No. 23768.

II.

Interest Synchronization

DoD and HECO dispute the issue of interest synchronization. In DoD's Exception and briefs, it proposes the interest synchronization method for calculating HECO's interest expense.⁷ HECO, however, maintains that "[HECO's current] method for determining the interest expense deduction is consistent with prior [c]ommission decisions[.]"⁸

HECO's 2005 test year interest expense is \$27,911,000.⁹ HECO estimates the interest expense by calculating the interest on long-term debt and hybrid securities actually in place and on estimated additional long-term debt and short-term debt to be required in the test year.¹⁰ This total interest is then reduced by the debt portion of the allowance for funds used during

⁷See generally DoD's Exception; DoD's Opening Brief at 12.

⁸Settlement Agreement, Exhibit II at 8.

⁹See HECO-R-1702; HECO's 2nd September 19 filing, Attachment 3 at 5.

¹⁰See HECO T-17 at 8-9; HECO-WP-1702 at 2.

construction ("AFUDC") for the year.¹¹ In accordance with SFAS 109, HECO computes AFUDC on a pretax basis, and consequently, the debt portion of AFUDC reflects interest related to construction on a pretax basis.¹² The pretax debt portion of AFUDC represents the amount of estimated interest expense related to construction of capital assets and, according to HECO, should not impact the test year results of operations.¹³ This AFUDC is capitalized as part of the construction cost of those capital assets.¹⁴ The capitalized costs, including AFUDC, are subsequently recovered by HECO through depreciation expense and the related tax benefits are similarly passed to the customers in future years.¹⁵

HECO opposes interest synchronization. HECO explains that its current method of calculating interest expense is the same method used by HECO and the Consumer Advocate in Docket Nos. 7700 and 7766.¹⁶ HECO notes that the commission already twice rejected DoD's previous proposals to adopt the interest synchronization method in Docket Nos. 6531 and 6998.¹⁷ HECO also adds that DoD admits that HECO's methodology for

¹¹See HECO T-17 at 9; HECO-WP-1702 at 2.

¹²See HECO T-17 at 9.

¹³See HECO T-17 at 9.

¹⁴See HECO T-17 at 9.

¹⁵See HECO T-17 at 9.

¹⁶See HECO's Opening Brief at 73-74.

¹⁷See HECO's Opening Brief at 74-75.

estimating interest expense is adequate.¹⁸ HECO states that if the commission adopts the interest synchronization method, the rate base amount must reflect the commission's decision on whether a prepaid pension asset is included in rate base.¹⁹

DoD proposes that the interest expense be calculated using the interest synchronization method.²⁰ Under the interest synchronization method, "the authorized weighted cost of debt [is multiplied by] the authorized rate base, to determine [the] interest expense[.]"²¹ DoD explains that the interest synchronization method is "theoretically sound because it will harmonize the interest deduction for calculating taxable income with the interest expense included in [the] cost of capital and [will] simplify the ratemaking process."²² DoD asserts that the interest synchronization method "is consistent from case to case and balances the concerns of all stakeholders in an impartial and equitable way."²³

In addition, in DoD's Exception, DoD asserts that the vast majority of state utility regulatory commissions have

¹⁸See HECO's Reply Brief at 41 (citing DoD's Opening Brief at 12).

¹⁹See HECO's Opening Brief at 75-76.

²⁰See DoD's Opening Brief at 12.

²¹DoD's Opening Brief at 10.

²²DoD's Opening Brief at 12.

²³DoD's Opening Brief at 12.

adopted the interest synchronization method.²⁴ Moreover, DoD contends that any uncertainties surrounding the use of interest synchronization that existed in the 1980s have been resolved overwhelmingly in favor of using interest synchronization.²⁵

The Consumer Advocate "takes no position on interest synchronization."²⁶ The Consumer Advocate explains that it "stated its preference for using interest synchronization, but did not recommend its use in Direct Testimony in light of prior [c]ommission rulings on the matter."²⁷

Based on a full review of the entire record, the commission determines that the interest synchronization method for calculating interest expense should be adopted in this case. In doing so, the commission finds that interest synchronization will improve the ratemaking process and has several advantages over the method traditionally used by HECO. In particular, interest synchronization simplifies rate case proceedings by reducing the calculation of the interest expense to a single mathematical formula where the amounts in the formula (i.e., rate base and weighted cost of debt) have already been determined in the ratemaking process. Thus, interest synchronization serves to

²⁴DoD's Exception at 4.

²⁵DoD's Exception at 2-4.

²⁶Consumer Advocate's Opening Brief at 35.

²⁷Consumer Advocate's Opening Brief at 35; see also Settlement Agreement, Exhibit II at 8 ("Although [the Consumer Advocate's direct testimony] discusses the Consumer Advocate's preference for use of the interest synchronization method for ratemaking purposes, the Consumer Advocate's filing did not use this methodology in deference to prior [c]ommission decisions.").

narrow the potential for disputes over the interest expense calculation in rate cases.

Moreover, interest synchronization has the advantage of providing symmetry, certainty, and consistency in ratemaking. As asserted by DoD, "the interest synchronization method is necessary in order to properly match and coordinate the components of the ratemaking process."²⁸ "HECO's method is dependent upon such varying items as interest on long-term debt and hybrid securities and the estimated interest on short-term debt, as well as the pretax debt portion of [AFUDC]. Any of these items can change from year-to-year. . . . Ultimately, HECO's method is inferior to interest synchronization because it does not coordinate and match the capital structure, rate base and statement of net operating income."²⁹

The commission acknowledges that it has declined to adopt interest synchronization in prior rate cases due to "uncertainties surrounding its use."³⁰ Those decisions, however, were issued over a decade ago, and since then, it appears that the uncertainties referenced in the commission's prior decisions have been resolved in favor of using interest synchronization. In fact, the Federal Energy Regulatory Commission and many state

²⁸DoD's Exception at 4.

²⁹DoD's Exception at 2.

³⁰See In re Hawaiian Elec. Co., Inc., Decision and Order No. 11317, filed on October 17, 1991, in Docket No. 6531; In re Hawaiian Elec. Co., Inc., Decision and Order No. 11699, filed on June 30, 1992, in Docket No. 6998.

commissions now consistently apply interest synchronization as a legitimate and appropriate ratemaking method.

Accordingly, for all of the reasons addressed above, and given the general widespread acceptance of interest synchronization since the commission's prior decisions rejecting interest synchronization, the commission finds it reasonable to depart from its prior decisions on interest synchronization, and instead, officially adopt it as the mechanism for computing interest expense in this case.³¹

The commission recognizes that its decision herein will affect the amounts shown in the results of operation schedules attached to Amended Proposed Decision and Order No. 23768. Accordingly, the commission directs the Parties to file stipulated revised results of operation schedules, within fourteen days of the date of this Order, which reflect amounts consistent with the commission's decisions in this Order and Amended Proposed Decision and Order No. 23768, for the commission's review and approval. Alternatively, if the Parties are unable to agree on revised results of operation schedules, the Parties shall submit, by the same date, proposed revised schedules for the commission's consideration. The commission

³¹An administrative agency may depart from past precedent as long as it provides a reasoned explanation. See Ramaprakash v. FAA, 346 F.3d 1121, 1124 (D.C. Cir. 2003) ("Agencies are free to change course as their expertise and experience may suggest or require, but when they do so they must provide a reasoned analysis") (quotation omitted); see also Kahale v. City and County of Honolulu, 104 Hawai'i 341, 348, 90 P.3d 233, 240 (S.Ct. 2004) ("[G]reat consideration should always be accorded precedent . . . Yet, it does not necessarily follow that a rule established by precedent is infallible.").

will issue a final Decision and Order in this docket following review and approval of the Parties' stipulated (or proposed) revised schedules.

III.

Orders

THE COMMISSION ORDERS:

1. The interest synchronization method is officially adopted as the mechanism for computing interest expense in this case.

2. The Parties shall file stipulated revised results of operation schedules, within fourteen days of the date of this Order, which reflect amounts consistent with the commission's decisions in this Order and Amended Proposed Decision and Order No. 23768, for the commission's review and approval, and for subsequent incorporation into the commission's final Decision and Order in this docket. Alternatively, if the Parties are unable to agree on revised results of operation schedules, the Parties shall submit, by the same date, proposed revised schedules for the commission's consideration.

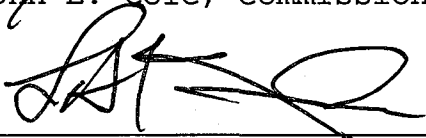
DONE at Honolulu, Hawaii

MAR - 4 2008


PUBLIC UTILITIES COMMISSION
OF THE STATE OF HAWAII

By 
Carlito P. Caliboso, Chairman

By 
John E. Cole, Commissioner

By 
Leslie H. Kondo, Commissioner

APPROVED AS TO FORM:


Kaiulani Kidani Shinsato
Commission Counsel

04-0113.sl

CERTIFICATE OF SERVICE

I hereby certify that I have this date served a copy of the foregoing Order No. 24068 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: MAR - 4 2008