BEFORE THE PUBLIC UTILITIES COMMISSION

OF THE STATE OF HAWAII

In the Matter of the Application of HAWAIIAN ELECTRIC COMPANY, INC. For Waiver of the Airport Dispatchable Standby Generation Project from the Competitive Bidding Framework, Approval of a Dispatchable Standby Generation Agreement with the State of Hawaii, Department of Transportation, Approval of the Dispatchable Standby Generation Project Cost Accounting, Approval to Include the Project Fuel Costs in Hawaiian Electric Company, Inc.'s Energy Cost Adjustment Clause, and Approval to Commit Funds in Excess of $2,500,000.	DOCKET NO. 2008-0329

DECISION AND ORDER

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2009 JUN 26 A 9:33
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PUBLIC UTILITIES
COMMISSION

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DECISION AND ORDER

By this Decision and Order, the commission approves in part, denies in part, and defers in part the requests set forth in the Application of HAWAIIAN ELECTRIC COMPANY, INC. ("HECO" or "Company"), filed on December 31, 2008.[1] Accordingly, the commission: (1) approves the waiver of the Airport Dispatchable Standby Generation ("DSG") Project from the commission's

[1]Application; Verification; Exhibits 1 to 5; and Certificate of Service, filed on December 31, 2008 (collectively, "Application"). The Parties are HECO and the DEPARTMENT OF COMMERCE AND CONSUMER AFFAIRS, DIVISION OF CONSUMER ADVOCACY ("Consumer Advocate"), an ex officio party to this proceeding, pursuant to Hawaii Revised Statutes ("HRS") § 269-51 and Hawaii Administrative Rules ("HAR") § 6-61-62(a). On February 10, 2009, the commission denied Life of the Land's motion to intervene. See Order Denying Life of the Land's Motion to Intervene, filed on February 10, 2009.

Framework for Competitive Bidding, dated December 8, 2006 ("CB Framework"); (2) approves the DSG Agreement, dated September 24, 2008, subject to the conditions noted herein; (3) approves the commitment of funds for the DSG Project, currently estimated at $3.4 million (exclusive of customer contributions); (4) denies HECO's proposed accounting and ratemaking treatments for the DSG Capital Expense Budget and Overhaul Cost Reimbursement; and (5) defers until a future HECO application the electric utility's request to seek the recovery of certain of its fuel-related costs through its Energy Cost Adjustment Clause ("ECAC").

I.

Background

HECO is the franchised provider of electric utility service on the island of Oahu. For purposes of this proceeding, the State of Hawaii ("State"), Department of Transportation ("DOT"), Airports Division ("DOT Airports"), is the contracting party with HECO. On the island of Oahu, DOT operates and maintains the Honolulu International Airport ("HNL Airport" or "Airport").[2]

[2] See HRS chapter 261, Aeronautics.

A.

Application

On December 31, 2008, HECO filed its Application requesting commission action on various matters related to the DSG Project. Specifically, HECO requests that the commission:

1. Waive the DSG Project from the commission's CB Framework, pursuant to Parts II.A.3.b(i), b(iii), b(iv), c(iii), and d of the CB Framework;

2. Approve the DSG Agreement, dated September 24, 2008, between HECO and DOT Airports, pursuant to HECO's Tariff Rule 4;

3. Approve the commitment of funds for the DSG Project, currently estimated at $3.4 million (exclusive of customer contributions), pursuant to Section 2.3.g.2 of General Order No. 7, Standards for Electric Utility Service in the State of Hawaii ("G.O. No. 7"), as modified by Decision and Order No. 21002, filed on May 27, 2004, in In re Hawaiian Elec. Co., Inc., Hawaii Elec. Light Co., Inc., and Maui Elec. Co., Ltd., Docket No. 03-0257 ("Docket No. 03-0257");[3]

4. Approve the inclusion of HECO's DSG fuel costs, ground transportation costs, and related taxes, in HECO's ECAC, to the extent that such costs are not recovered in HECO's base rates, pursuant to HAR § 6-60-6; and

[3]In Docket No. 03-0257, the commission increased the monetary threshold governing the filing of capital expenditure applications by HECO, from $500,000 to $2.5 million, exclusive of customer contributions, effective from July 1, 2004.

5. Approve the proposed accounting and ratemaking treatments for the DSG Capital Expense Budget and Overhaul Cost Reimbursement.

By its Application, HECO also advises the commission and the Consumer Advocate of several other matters to which it does not affirmatively seek commission action in this proceeding. Specifically, as described by HECO:[4]

1. In May 2003, the Emerging Issues Task Force ("EITF") of the Financial Accounting Standards Board issued EITF No. 01-08, "Determining Whether an Arrangement Constitutes a Lease." Based on a preliminary evaluation of the DSG Agreement, it appears that the agreement: (A) constitutes a léase transaction in accordance with EITF No. 01-08; and (B) will be classified as an operating lease in accordance with the Statement of Financial Accounting Standards No. 13, "Accounting for Leases." Thus, HECO will record the Dispatchable Generation Incentive payments "as [a] lease expense over the lease term as they become payable." Application, at 43; <u>see also</u> HECO's response to CA-IR-11.a (HECO's conclusion that the DSG Agreement is an operating lease).

2. The credit rating agencies impute debt for HECO's long-term operating lease obligations. In essence, "[i]mputed debt at inception is estimated to be approximately $4,300,000, with annual rebalancing costs estimated at about $360,000. The amount of imputed debt and related rebalancing costs will decline over the term of the agreement." Application, at 44.

3. The Airport DSG Project budget allocates $3.4 million for costs related to HECO's equipment, as identified in Exhibit 1 of the DSG Agreement. "HECO proposes to include the HECO DSG equipment as utility assets, with revenue requirements based on the conventional useful service lives of the DSG equipment. Upon early or normal termination of the Airport DSG Project, the

[4]The acronym EPF, as used by HECO, refers to the emergency planned facility, i.e., the planned emergency generation facility.

protection, communication, and other equipment would be returned to HECO inventory for use on other projects requiring such equipment." Application, Section XII.3.b, HECO DSG Equipment, at 45.

4. Rate recovery will be requested in HECO's next general rate case for the revenue requirements resulting from the operations, maintenance, and monitoring costs for the DSG Project, including the monthly Dispatchable Generation Incentive payment and Annual Maintenance Allowance, as defined in Exhibit 4 of the DSG Agreement. "HECO will also allocate labor resources for the monitoring of the EPF, the review of reimbursements for fuel and maintenance expenses, and other DSG related activities." Application, Section XII.3.c., Operating and Maintenance Expenses for the Airport DSG Project, at 46.

Lastly, HECO proposes to file an annual DSG Project status report with the commission:

> In order to provide the Commission and Consumer Advocate with timely information on the Airport DSG Project, HECO will submit to the Commission and Consumer Advocate an annual status report by February 28 of each year of the EPF operation that will include the following information: 1) EPF run hours, 2) estimated versus actual kW and kWh output of the EPF Generators, and 3) a summary of reimbursable maintenance and fuel costs.

Application, at 49.

B.

The DSG Project and Agreement

According to HECO:

> HNL [Airport] currently has about 1.7 MW of permanent emergency power capacity which is sufficient to serve its runway lights, elevators and a few other critical loads. However, the HNL [Airport] electrical loads are fed using multiple electrical vaults with a total peak load of about 14 MW. DOT Airports installed an additional

6.5 MW of rental generators following the October [island-wide] 2006 outage, however those units are meant as a temporary measure until the EPF is built.

Application, at 21.

The DSG Project involves the: (1) construction of DOT Airports' planned EPF at the HNL Airport as a DSG system; and (2) operation and maintenance of the EPF pursuant to the terms of the DSG Agreement.

As described by HECO, the EPF will consist of:

> . . . . four, 2.0 MW, biodiesel-fueled, quick-start generating units to be installed adjacent to HECO's Airport Substation, and operated and maintained under the terms and conditions of the DSG Agreement between HECO and DOT Airports. Pursuant to the DSG Agreement, the EPF will be an emergency power plant owned by DOT Airports with the primary purpose of providing emergency power to the prioritized HNL electrical loads within five minutes of a utility grid outage, and secondary purpose to allow HECO dispatch of the units for additional generation capacity for up to 1,500 hours per year.

Application, at 8.

> The EPF will be owned by DOT Airports and will be constructed on a portion of DOT Airports['] property which is currently part [of] HECO's Airport Substation. The Airport DSG Project will require realignment of the Substation boundaries prior to start of construction. State Board of Land and Natural Resources ("BLNR") approval will be required for the revised boundaries as well as the land lease terms and conditions. The start of construction is targeted for May 2009 and is dependent on the BLNR approval of the revised Airport Substation boundaries and the Commission's approval of this Application.
>
> The EPF, containing four 2.0 MW (continuous rating) biodiesel-fueled engine gensets, will be interconnected to HECO's 12 kV system at the Airport Substation, on the utility side of the customer meters. Under the DSG Agreement, the use of the EPF for emergency power has the highest

> priority. HECO will be allowed to operate the EPF to generate power for utility system needs, up to 1,500 hours per year. In the event of a grid outage, the DSG operation will be terminated and the EPF and HNL [Airport] loads will be electrically isolated from the HECO grid so that the EPF will generate up to 10 MW of emergency power to serve the DOT Airport loads. In all circumstances, power produced by the EPF will be considered HECO-generated power, meaning that DOT Airports will be billed for the power even during times of emergency power generation.

Application, at 3-4 (footnote and text therein omitted).

> . . . . HECO intends to use biodiesel for the Airport DSG Project, provided that the fuel can be procured at a reasonable cost from a reliable source with the fuel specifications as required by the air permit and with the fuel purchase agreement approved by the Commission. A backup plan is to use diesel as a secondary fuel source or jet fuel if biodiesel or diesel fuel is unavailable. The EPF will be unmanned, dispatched remotely by HECO from its Ward Avenue dispatch office. Remote monitoring will be conducted by HECO. The EPF will normally operate to serve HECO system needs, but in instances where grid power is lost to the Airport Substation, the EPF will automatically operate to provide emergency power to HNL [Airport].

Application, at 21.[5]

HECO's total capital budget for the DSG Project is $5,793,000, and consists of three major categories: (1) a contribution-in-aid-of-construction ("CIAC") of $1,993,000, payable by DOT Airports to HECO, for equipment and installation costs to accommodate the emergency use mode of the EPF by DOT Airports;[6] (2) DSG capital costs of up to $400,000,

[5]HECO is responsible for procuring the fuel for the EPF according to its specifications.

[6]DSG Agreement, Exhibit 3, Contribution for HECO Equipment for the State's Emergency Mode Use of Facility; and Application, Exhibit 3, Estimate Cost Worksheet.

reimbursable by HECO to DOT Airports, for cost increases incurred by DOT Airports in configuring the EPF to enable the generators to operate in parallel with HECO's grid under utility dispatch, referred to as HECO's DSG Capital Expense Budget in the DSG Agreement;[7] and (3) $3,400,000 in HECO-incurred capital costs, for "the design, equipment, installation, project management, and other costs related to the HECO equipment which includes communication, interconnection, protection, and monitoring of the DSG Generators."[8] The total estimated cost of the EPF, in turn, is $28 million.[9]

HECO estimates that the EPF will be completed and available for emergency operation and utility dispatch (i.e., commercial operation) in July 2010.

Pursuant to the terms of the DSG Agreement:

1. DOT Airports will design and equip the EPF to: (A) allow the generators to operate in parallel with HECO's grid and for HECO to remotely dispatch and operate the generators in parallel mode "for up to one thousand five hundred (1,500) run-hours per individual Generator per rolling 12-month period,

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[7]See Application, Section IX, Airport DSG Capital, at 36; Section XI.1, DSG Equipment to be Customer Equipment, at 41; Section XII.3.a, DSG Capital Expense Budget; Exhibit 3, Cost Estimate Worksheet; and DSG Agreement, Section 5.7, and Exhibit 4, Paragraph 5, DSG Total Capital Expense Budget.

[8]Application, Section XII.3.b, HECO DSG Equipment, at 45, and Exhibit 3, Cost Estimate Worksheet; see also Application, Section IX, HECO's DSG Capital, at 36-37; and HECO's responses to CA-IR-6, revised (project activities for the HECO-incurred capital cost components), and CA-IR-7 (supporting calculations and workpapers).

[9]Application, at 27.

subject to compliance with all applicable air permit limitations[;]"[10] and (B) serve DOT Airports' load in isolation from HECO's grid, separate from the Airport Substation, i.e., in emergency mode. In general, subject to the terms of the agreement: (A) HECO has the right to start, operate, and distribute power from the EPF to HECO's grid in parallel mode; and (B) DOT Airports has the right to operate the EPF to serve the HNL Airport load in emergency mode.[11]

2. The equipment to be installed and owned by either DOT Airports or HECO is set forth in Exhibit 1, System Overview & Equipment Summary.[12] In general, DOT Airports will install and own the EPF, including the generators, related equipment, and fuel system, while HECO will install and own the equipment utilized to interconnect the EPF to HECO's Airport Substation.

3. Operational protocols for the EPF, as set forth in Exhibit 5, Facility Operations Protocol, include: (A) providing emergency power to the HNL Airport is the highest priority; (B) DOT Airports is only allowed to operate the EPF for emergency power operations or generator maintenance, when isolated from

[10]DSG Agreement, Exhibit 4, Dispatchable Standby Generation Incentives and Conditions, Section 4, Maximum Utility Dispatch.

[11]DSG Agreement, Sections 1.1 and 1.2; see also Exhibit 5, Facility Operations Protocol, Section 2, HECO Operation of the Facility (HECO may operate the generators only in parallel mode; HECO shall not be allowed to start the generators in emergency mode).

[12]See also DSG Agreement, Section 2, State Equipment and Responsibilities, Section 3, HECO Equipment and Responsibilities, Exhibit 2, Facility Equipment Owned by the State, and Exhibit 3, Contribution for HECO Equipment for the State's Emergency Mode Use of Facility.

HECO's grid; (C) HECO is only allowed to operate the EPF in parallel with its grid, and dispatch the EPF to a maximum of 1,500 hours per year; and (D) HECO will dispatch the EPF at a continuous rating of 8 MW.[13]

4. The contracting party's responsibilities for facility testing, maintenance, and refueling are set forth in Exhibit 6, Facility Testing, Maintenance, and Refueling.[14] In general, DOT Airports is responsible for the maintenance of the EPF, its fuel infrastructure, and for operating the EPF in emergency mode, while HECO is responsible for procuring and transporting the fuel to DOT Airports' fuel storage tanks.[15] DOT Airports must develop and implement a Maintenance Plan for the EPF.

5. Exhibit 3, Contribution for HECO Equipment for the State's Emergency Mode Use of Facility, describes the upgrades and additional equipment needed to interconnect the EPF to HECO's Airport Substation for the purpose of operating the EPF in

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[13] See also DSG Agreement, Exhibit 6, Facility Testing, Maintenance, and Refueling, Section 1, Acceptance Test, Section 2, Periodic Functional Test, Section 3, State Routine Maintenance and Training on Facility and State Equipment, i.e., the Maintenance Plan, and Section 4, Fuel System Responsibilities; DSG Agreement, Section 4, Operation Rights and Protocols; and DSG Agreement, Exhibit 4, Dispatchable Standby Generation Incentives and Conditions, Section 4, Maximum Utility Dispatch.

[14] See also DSG Agreement, Section 2.2, Maintenance Plan.

[15] HECO shall also own the fuel and be responsible for the fuel costs. DSG Agreement, Section 2.3, State Fuel Storage Tank, Fuel Piping and Fuel, and Section 5.2, Refueling and Payment of Fuel Costs.

emergency mode. DOT Airports agrees to pay HECO a CIAC fee of $1,993,000, to procure and install the HECO-owned interconnection facilities, with a true-up upon the completion of the DSG Project.

6. All electricity produced by the EPF will be considered HECO-generated electricity.[16] Accordingly, DOT Airports will pay HECO for the EPF-generated electricity at the applicable tariff rate, regardless of whether the electricity is supplied from HECO's grid or the EPF generators, or whether the generators are operating in parallel or emergency mode. In no event shall DOT Airports operate the EPF for the purpose of "peak shaving" or to reduce the cost of electricity purchased from HECO.

7. Exhibit 4, Dispatchable Standby Generation Incentives and Conditions, sets forth certain payments, allowances, and reimbursements:

A. Dispatchable Generation Incentive ("DGI") Payment:[17] HECO shall pay DOT Airports a DGI rate of $4.00 per kW, each month, for the continuous power output of the EPF, which equates to $384,000 per year, if the total 8,000 kW net output of the EPF is provided at the continuous rating for the generators and subject to other specified conditions.[18] In particular,

[16]DSG Agreement, Section 5.1, Payment for Electricity.

[17]DSG Agreement, Section 5.3, Payment of Dispatchable Generation Incentive.

[18]HECO's response to CA-IR-2a (DGI rate of $4.00 per kW).

the DGI payments will be made by HECO to DOT Airports, provided that the generators are available for parallel mode operation at least ninety percent of the hours of the prior monthly billing period. DGI payments will be suspended: (1) in the monthly billing period following a billing period where the generators fail to meet the specified availability requirement, with payments to resume once the generators meet the availability requirement for a complete monthly billing period; or (2) in any monthly billing period during which DOT Airports fails to comply with the Maintenance Plan set forth in Exhibit 6, with payments to resume following HECO's written verification that DOT Airports has "come back" into full compliance with the Maintenance Plan.

B. Annual Repairs and Routine Maintenance Allowance:[19] Upon the successful completion of the Acceptance Test, HECO shall reimburse to DOT Airports an Annual Routine Maintenance Allowance of up to $225,000 per contract year, with escalation beginning in 2010, based on the previous calendar year's Gross National Product Implicit Price Deflator ("GNPIPD") index. Specifically, HECO will reimburse DOT Airports for periodic inspections and maintenance, repair work, fuel system maintenance costs, and other related costs as described in Exhibit 6 of the agreement.

[19]DSG Agreement, Section 5.4, Payment of Maintenance Expenses, and Exhibit 6, Section 2, Periodic Functional Test.

C. HECO's DSG Capital Expense Budget:[20] HECO agrees to reimburse DOT Airports for DSG capital expenses of up to $400,000.[21]

D. Overhaul Cost Reimbursement: HECO will reimburse DOT Airports for engine overhaul costs, limited to $175,000 per engine, per overhaul, subject to escalation beginning in 2010, based on the previous calendar year's GNPIPD index.[22]

E. DOT Airports shall reimburse HECO for the costs incurred by the utility for the equipment and labor required to implement the emergency mode use of the EPF, pursuant to Exhibit 3 of the agreement.[23]

8. Exhibit 8, General Terms and Conditions, includes provisions governing insurance, property damage and other responsibilities, limitation of liability, termination of the agreement for cause, dispute resolution, and force majeure.

9. The agreement is subject to certain conditions, including: (A) the commission's issuance of a written decision that approves the DSG Agreement upon terms that are acceptable to HECO, including "allow[ing] HECO to include the reasonable

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[20]DSG Agreement, Section 5.7, Payment for DSG Capital Expenses, Exhibit 1, System Overview & Equipment Summary, Section 2, State Equipment, and Exhibit 4, Dispatchable Standby Generation Incentives and Conditions, Section 5, DSG Total Capital Expense Budget.

[21]HECO's response to CA-IR-2a (DSG Capital Expense Budget of $400,000).

[22]HECO's response to CA-IR-2a (Overhaul Cost Reimbursement of $175,000, per engine, per overhaul).

[23]DSG Agreement, Section 5.9, State Reimbursement Payments.

costs incurred by HECO pursuant to [the DSG] Agreement in its revenue requirements for ratemaking purposes and for the purposes of determining the reasonableness of HECO's rates[;]"[24] (B) HECO obtaining a Covered Source Air Permit for the EPF;[25] and (C) the approval and execution of an Airport Land Lease Agreement.[26]

10. The term of the agreement is for twenty years from the date of HECO's written approval of the Acceptance Test (the "Initial Term"), with the agreement subject to automatic renewal for an additional two-year term, unless one party notifies the other party in writing of the party's intent to not extend the agreement, prior to the expiration of the Initial Term.[27] Moreover, the contracting parties have the right to terminate the agreement, subject to certain conditions and payment terms, to the extent applicable,[28] or upon material breach, without cure by the other contracting party.[29]

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[24]DSG Agreement, Section 7.1, Regulatory Approval.

[25]The Covered Source Air Permit was issued by the State Department of Health on December 11, 2008. Application, at 32 n.18.

[26]DSG Agreement, Section 7, Approvals and Effective Date.

[27]DSG Agreement, Section 6.1, Term.

[28]DSG Agreement, Section 6, Term & Early Termination, and Exhibit 7, Payment Upon Termination Schedule.

[29]DSG Agreement, Exhibit 8, General Terms and Conditions, Section 9, Termination by the State for Cause, and Section 10, Termination by HECO for Cause.

11. The DSG Agreement shall take effect upon HECO's receipt of the commission's approval, the Covered Source Air Permit Approval Notice, and the approved and executed Airport Land Lease Agreement.[30]

C.

HECO's Position

In support of its Application, HECO states:

1. The waiver of the DSG Project from the CB Framework is consistent with Parts II.A.3.b(i), b(iii), b(iv), c(iii), and d of the CB Framework, governing waivers.

2. The DSG Project is listed in the Renewable Energy Commitments section of the Hawaii Clean Energy Initiative Agreement, dated October 20, 2008 (the "HCEI Agreement"), "as a biofueled resource and one that will employ quick starting engine generators and . . . will directly provide additional renewable energy to HECO's system."[31]

3. The DSG Agreement represents an optimal solution to simultaneously satisfy DOT Airports' need for emergency power and HECO's need for dispatchable renewable generation capacity. In this regard, the DSG Agreement will enable HECO to obtain 8 MW of quick-starting, dispatchable renewable generation in a

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[30]DSG Agreement, Section 7.4, Effective Date.

[31]Application, at 5. The parties to the HCEI Agreement: (1) are HECO and the State, including the Consumer Advocate; and (2) commit to "mov[ing] more decisively and irreversibly away from imported fossil fuel for electricity and transportation and towards indigenously produced renewable energy and an ethic of energy efficiency." HCEI Agreement, at 1.

cost-effective manner to serve the electric utility's needs and assist DOT Airports with supplying critically needed emergency power capabilities at the Airport.

Furthermore:

> . . . . DOT Airports will benefit from HECO's assistance in designing, developing, operating and maintaining the EPF, and from HECO's financial payments to DOT Airports in exchange for use of the EPF. Additionally, DOT Airports has determined that there are no other sites suitable for building a centralized EPF. By siting the EPF next to HECO's Airport Substation, interconnecting into HECO's 12 kV system, and allowing HECO to generate the power, DOT Airports will be able to develop a more robust and efficient centralized EPF that makes use of existing HECO infrastructure, rather than install standby generators at multiple electrical vault locations throughout HNL [Airport].
>
> . . . . The DSG Agreement, by establishing that power from the EPF is HECO-generated electricity, provides the network by which that power may flow through the HECO system to serve HNL [Airport]. Without Commission approval of the use of the Airport Substation infrastructure through the DSG Agreement, DOT Airports would need to install new distribution feeders of its own to connect the EPF with HNL [Airport] electrical vaults.

Application, at 4-5; <u>see also</u> <u>id.</u> at 13-14 (benefits for DOT Airports).

4. HECO undertook and completed a cost analysis that compared the DSG Project, including the DGI payments and maintenance reimbursement, with a hypothetical utility-owned DG facility (twenty-year service life). Pursuant to the results of its cost analysis, "the levelized revenue requirement per kW-year of the DSG Agreement is approximately $206/kW-year, as opposed to

approximately $300/kW-year for a comparable hypothetical utility facility utilizing five 1.64 MW containerized diesel-generating units with two 12,000 gallon fuel tanks, and operation, maintenance and other attributes similar to those of the Airport DSG Project."[32] As a result, HECO concludes that the DSG Agreement is cost-effective and favorable, in comparison to the development of a utility-owned facility of a similar size.

D.

Consumer Advocate's Position

On May 1, 2009, the Consumer Advocate filed its Statement of Position, stating that it does not object to the commission's approval of HECO's Application.[33] In support of its position, the Consumer Advocate states:

1. The primary support for a waiver from the competitive bidding process is that HECO's acquisition of the capacity from the EPF is in the public interest, consistent with Part II.A.3.d of the CB Framework. In this regard:

> . . . . The Airport DSG Project appears to: (1) support the construction of the emergency back-up power for a critical facility of the State of Hawaii in which funding for the project has already been approved by the Legislature; and

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[32]Application, at 10-11 (footnote and text therein omitted); see also HECO's Exhibit 2, Economic Analysis; HECO's Exhibit 3, Cost Estimate Worksheet; HECO's Exhibit 4, Operation & Maintenance Allowance Worksheets; and HECO's response to CA-IR-5 (workpapers for Exhibits 2 and 4).

[33]Consumer Advocate's Statement of Position; and Certificate of Service, filed on May 1, 2009 (collectively, "Statement of Position").

> (2) although the EPF quick-starting capability will be unavailable to assist in bringing up HECO's [generators] in an island-wide blackout situation, the HNL [Airport's] ability to sustain its own operations will allow HECO to focus its resources on bringing service up to its others customers. In addition, . . . due to the unique situation, the Consumer Advocate believes a competitive bidding process would be unproductive and is one of the principle . . . reasons in which the Commission will grant a waiver.

Consumer Advocate's Statement of Position, at 7-8 (footnotes and text therein omitted).

2. The DSG Project "is the first application in which an electric utility is proposing to dispatch a customer-owned <u>standby</u> generation facility for system grid use . . . [and] the situation is unique in which HECO owns the distribution facilities that the DOT Airports will be using . . . to transmit its standby generation from the EPF site to HNL [Airport]."[34]

3. While it is difficult to determine whether the levels of individual reimbursement to DOT Airports are reasonable, based on HECO's revenue requirements analysis, it appears that the overall cost to ratepayers is lower for the DSG Project than if HECO constructed its own distributed generation facility. As a result, and in consideration of the public benefits and unique circumstances of the DSG Project, the Consumer Advocate does not object to the terms and conditions of the DSG Agreement.

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[34] Consumer Advocate's Statement of Position, at 8 (emphasis in original)(footnote and text therein omitted).

4. The Consumer Advocate does not object to the inclusion of HECO's DSG fuel costs and related taxes in the electric utility's ECAC, to the extent that such costs are not "received" in the utility's base rates.

5. "The Consumer Advocate does not object to the proposed ratemaking treatment of the costs associated with the Airport DSG Project at this time. The Consumer Advocate notes, however, that the exact amount of the reimbursements (Capital Expenditure Budget, Operating and Maintenance Expenses, Overhaul Cost) to the DOT Airports is not known at this time. As such, the Consumer Advocate reserves its right to address the amount to be recovered from ratepayers at the time of [HECO's] next rate proceeding."[35]

E.

HECO's Reply

By letter dated May 13, 2009, HECO responds to the Consumer Advocate's Statement of Position as follows:

> It is the Company's understanding that the Consumer Advocate does not object to the proposed accounting and ratemaking treatment[s] of the DSG Capital Expense Budget and Overhaul Cost Reimbursement. It is the Company's further understanding that the Consumer Advocate does not object to the Company implementing this treatment, upon the payment of these costs, which may occur prior to its next rate proceeding. This treatment includes recording these amounts as deferred debits, including the unamortized costs in rate base and amortizing over the periods

[35] Consumer Advocate's Statement of Position, at 10-11.

> described in Section XII of the Application, filed December 31, 2008. The Company understands that the Consumer Advocate reserves its right to address the amounts deferred and included in rate base, as well as the annual amortization, at the time of the Company's next rate proceeding.
>
> Wherefore, HECO respectfully informs the Commission that this proceeding is now ready for decision making.

HECO's letter, dated May 13, 2009, at 1 (emphasis added).

II.

Discussion

A.

Waiver from the CB Framework

Part II.A.3 of the CB Framework, governing waivers from the competitive bidding process, states in relevant part:

> b. Under certain circumstances, to be considered by the Commission in the context of an electric utility's request for waiver under Part II.A.4, below, competitive bidding may not be appropriate. These circumstances include: (i) when competitive bidding will unduly hinder the ability to add needed generation in a timely fashion; (ii) when the utility and its customers will benefit more if the generation resource is owned by the utility rather than by a third-party (for example, when reliability will be jeopardized by the utilization of a third-party resource); (iii) when more cost-effective or better performing generation resources are more likely to be acquired more efficiently through different procurement processes; or (iv) when competitive bidding will impede or create a disincentive for the achievement of IRP goals, renewable energy portfolio standards or other government objectives and policies, or conflict with requirements of other controlling laws, rules, or regulations.

c. Other circumstances that could qualify for a waiver include: (i) the expansion or repowering of existing utility generating units; (ii) the acquisition of near-term power supplies for short-term needs; (iii) the acquisition of power from a non-fossil fuel facility (such as a waste-to-energy facility) that is being installed to meet a governmental objective; and (iv) the acquisition of power supplies needed to respond to an emergency situation.

d. Furthermore, the Commission may waive this Framework or any part thereof upon a showing that the waiver will likely result in a lower cost supply of electricity to the utility's general body of ratepayers, increase the reliable supply of electricity to the utility's general body of ratepayers, <u>or is otherwise in the public interest</u>.

CB Framework, Part II.A.3 (emphasis added).

The HNL Airport serves a critical function for the financial, economic, and social well-being of the State, its residents, and visitors alike. Its continual operation in the event of a prolonged power outage, such as during the island-wide blackouts on October 15, 2006 and December 26, 2008, is vital to the health, safety, and welfare of airline passengers, employees, staff, and others, including emergency and law enforcement personnel. In short, it is reasonable to expect that in the event of an extended power outage, the airport should continue to function without any major interruptions or delays. The ripple effect resulting from the full or partial closure of the HNL Airport's operations is of statewide, national, and international consequence and concern.

Given this scenario, the commission finds that the EPF, once completed and interconnected with HECO's Airport Substation, will serve the public interest by providing up to 10 MW of quick-starting, emergency power to serve the HNL Airport load, in the event of a power outage. As a result, major disruptions to the HNL Airport's operations should, in the future, be avoided or minimized. Moreover, as explained by HECO, in the event of an island-wide power outage:

> The Airport ownership of the emergency standby generating facility will allow the Airport to sustain its operations during an island-wide blackout. This will in turn allow HECO to focus its resources, including trouble crews, on restoring service to other customers. As HECO incrementally brings generators back on-line, the available generating capacity can be used to restore customer loads other than the Airport loads, since the priority Airport loads will be self-sustaining with its new emergency standby generating facility.

HECO's response to CA-IR-10.

Based on the foregoing reasons, the commission approves HECO's request to waive the DSG Project from the CB Framework, pursuant to Part II.A.3.d of the framework.

B.

The DSG Agreement and the
<u>Expenditure of Funds for the DSG Project</u>

HECO's Tariff Rule 4, governing special contracts, provides:

> Special contracts for service other than that provided under the tariffs or attached form contracts must be authorized by the Public Utilities Commission prior to the effective date of said contract.

> Each contract for service will contain a statement that it shall at all times be subject to changes or modifications by the Public Utilities Commission as said Commission may from time to time direct in the exercise of its jurisdiction.

HECO's Tariff Rule 4.

Section 2.3.g.2 of G.O. No. 7, as modified by Decision and Order No. 21002, in Docket No. 03-0257, provides:

> Proposed capital expenditures for any single project related to plant replacement, expansion or modernization, in excess of $2.5 million, excluding customer contributions, or 10 percent 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.

See Docket No. 03-0257, Decision and Order No. 21002, at 14-15.

The DSG Project, in essence, constitutes a *standby emergency* generation facility for DOT Airports' primary benefit. The EPF is designed as a permanent measure to replace the temporary generators installed by DOT Airports at various sites surrounding the HNL Airport, following the October 15, 2006 earthquake. Moreover, as a secondary resource, HECO has the option of operating the EPF for the purpose of generating power for its utility system needs, up to 1,500 hours per year. As represented by HECO, "[d]uring non-emergency situations, the power generated by the DSG facility is to be used in support of the overall grid and is not intended for the benefit of one customer."[36]

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[36]Application, at 26.

The DSG Project represents a unique approach by which the "DOT Airports, as the owner-developer of the EPF, is funding the vast majority of the facility's capital costs[,]"[37] while HECO, as the electric utility, will operate the EPF and charge DOT Airports for the electricity generated by the EPF at HECO's applicable tariff rate. Conversely, HECO will pay DOT Airports a monthly DGI rate for the continuous power output of the EPF, subject to certain conditions. As explained by HECO, "[a]lthough the proposed DSG System will be customer-owned, it will be operated by HECO to serve HECO's generating needs. In the rare event of emergency use, all power generated will be sold by HECO to DOT Airports."[38] Furthermore, the Consumer Advocate notes that the overall cost to ratepayers appears to be lower for the DSG Project than if HECO constructed its own distributed generation facility.

The DSG Agreement, meanwhile, "governs HECO's operation of the EPF generators at their continuous operation rating totaling 8 MW. During short term emergency operation, the EPF will be capable of generating up to 10 MW total."[39] The DSG Agreement, moreover, "is at all times subject to changes and modifications as the PUC may direct from time to time in the exercise of its jurisdiction."[40]

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[37]Application, at 4.

[38]Application, at 49.

[39]Application, at 2 n.2.

[40]DSG Agreement, Exhibit 8, General Terms and Conditions, Section 22, PUC Authority.

As set forth in the Application, "HECO intends to utilize biodiesel for the Airport DSG Project, provided that [biodiesel] can be procured at a reasonable cost from a reliable source with the fuel specifications as required by the [Covered Air Source Permit] and with the fuel purchase agreement approved by the [c]ommission."[41] HECO's back-up plan is to utilize fossil fuel (diesel, or if unavailable, jet fuel) as a secondary fuel source.

That HECO can utilize fossil fuel if it determines that it cannot procure biodiesel at a "reasonable cost" or from a "reliable source" is inconsistent with the underlying intent and spirit of the electric utility's stated pledge, as set forth in the HCEI Agreement, to refrain from "add[ing] any

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[41]Application, at 21. See HRS § 269-91 (the definition of renewable energy includes biofuels). Following the filing of its Application, HECO, as part of its memorandum in opposition to Life of the Land's motion to intervene, represented in pertinent part:

> 3. The fuel requirements of the Airport Distributed Standby Generation Project Emergency Power Facility ("EPF") are relatively small in comparison to those of HECO's Campbell Industrial Park CT-1 generation unit ("CT-1").
>
> 4. In order to benefit from economies of scale, HECO intends to procure fuel for the EPF from the biofuel supplier for CT-1.

Declaration of Scott Seu, dated January 27, 2009, at 1. On March 9 and 10, 2009, the commission, in In re Hawaiian Elec. Co., Inc., Docket No. 2007-0346 ("Docket No. 2007-0346"), held an evidentiary hearing on HECO's amended request to approve the amended biodiesel supply contract and the biodiesel terminalling and trucking agreement for the Campbell Industrial Park CT-1 generating unit. The commission's written decision in Docket No. 2007-0346 is pending.

new fossil-based generation over 2 MW beyond those already approved by the Commission or under construction without equivalent megawatthour retirements."[42] While customer-owned, HECO intends to operate the EPF in parallel for up to 1500 run hours per year. In doing so, it will avoid having to construct its own distributed generation facility.

Accordingly, HECO should be required to seek commission approval if it intends to run the units on fossil fuel for utility purposes. It would be inappropriate to allow the utility to operate the units on fossil fuel without notification to, or approval by, the commission. DOT Airports, however, as the customer, may operate the EPF in emergency mode using fossil fuel.

In sum, based on these reasons and the commission's rationale for waiving the DSG Project from the competitive bidding process, the commission finds that the DSG Project and Agreement appear reasonable and consistent with the public interest, provided that the use of fossil fuel for the EPF shall be limited to: (1) emergency mode operations by DOT Airports; or (2) parallel mode by HECO, subject to the commission's prior approval and contingent upon the electric utility's showing that there is a lack of reliable and cost effective supply of biodiesel and an essential need to run the EPF utilizing fossil fuel that could not reasonably be met with existing facilities.

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[42]HCEI Agreement, at 7; <u>see also</u> <u>id.</u>, Section 11, Displacement of Fossil Fuel Energy and "Retirements," at 21; and Application, Section XIV, HCEI, at 50-51.

With these stated conditions, the commission approves the DSG Agreement. Likewise, the commission approves HECO's commitment of funds for the DSG Project, currently estimated at $3.4 million (excluding customer contributions), which will be utilized by HECO for the utility-owned DSG-related equipment.

C.

HAR § 6-60-6

HAR § 6-60-6 states in relevant part:

> Automatic adjustment clauses. The utility's rate schedules may include automatic rate adjustment clauses, only for those clauses previously approved by the commission. Upon [the] effective date of this Chapter, any fuel adjustment clause submitted for commission approval shall comply with the following standards:
>
> (1) 'Fuel adjustment clause' means a provision of a rate schedule which provides for increases or decreases or both, without prior hearing, in rates reflecting increases or decreases or both in costs incurred by an electric or gas utility for fuel and purchased energy due to changes in the unit cost of fuel and purchased energy.
>
> (2) No changes in fuel and purchased energy costs may be included in the fuel adjustment clause unless the contracts or prices for the purchase of such fuel or energy have been previously approved or filed with the commission.
>
> . . . .

HAR § 6-60-6 (emphasis added).

At this juncture, a fuel source and supplier have not been procured by HECO for the EPF. Instead, once a fuel source and supplier have been procured by HECO, and any other necessary contingencies are met (including the issuance of an air permit), HECO intends to file an application requesting the commission's approval of the fuel purchase agreement.[43] Thus, the contract or price for the purchase of fuel or energy previously approved by or filed with the commission, as required by HAR § 6-60-6(2), are non-existent at this time.

Accordingly, the commission finds that HECO's request in this proceeding (Docket No. 2008-0329) to include its fuel costs, ground transportation costs, and related taxes in its ECAC, to the extent that such costs are not recovered in HECO's base rates, appears premature. Thus, no action will be taken by the commission on this request. Instead, the commission's ruling is deferred to HECO's future application seeking the commission's approval of the fuel purchase agreement.[44]

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[43]According to HECO, it also intends to submit a fuel purchase agreement for diesel fuel for the commission's approval, "should biodiesel become unavailable." Application, at 40; <u>see also</u> <u>id.</u>, at 48-49 (fuel contract for the supply of biodiesel and for back-up fuel of ultra low sulfur diesel); and HECO's response to CA-IR-15a (HECO will begin to negotiate the fuel transport contract following the establishment of the fuel supply contract for the EPF). Moreover, pursuant to Section 5.2 of the DSG Agreement, "[t]he type of fuel shall be selected in HECO's discretion[,]" and "HECO expects that the selected fuel will be diesel, biodiesel, or a diesel/biodiesel blend."

[44]<u>See, e.g.</u>, <u>In re Hawaiian Elec. Co., Inc.</u>, Docket No. 2007-0346 (requesting the commission's approval of HECO's biodiesel supply contract, and to include the contract costs in HECO's ECAC, for the Campbell Industrial Park Generation Station and Transmission Additions Project).

D.

Proposed Accounting and Ratemaking Treatments

HECO requests the commission's approval of its proposed accounting and ratemaking treatments for the DSG Capital Expense Budget and Overhaul Cost Reimbursement.[45]

1.

DSG Capital Expense Budget

Pursuant to the terms of the DSG Agreement, HECO will reimburse DOT Airports for DSG capital costs of up to $400,000, described as follows:

> Payment for DSG Capital Expenses: HECO shall reimburse the State, up to the Total Capital Expense Budget limits specified in Paragraph 5 of Exhibit 4, for the costs of designing, purchasing, and installing the State Equipment specifically required to enable HECO's DSG use of the Generators . . . . Reimbursable expenses shall

[45]HECO also requests that "the Commission allow HECO to include the reasonable costs incurred by HECO pursuant to the DSG Agreement in its revenue requirements for ratemaking purposes and for the purposes of determining the reasonableness of HECO's rates." Application, Section XII.3.c, Operating and Maintenance Expenses for the Airport DSG Project, at 46; see also Application, Section XII.3.f, Regulatory Treatment of the DSG Fuel Cost and Energy Cost Adjustment Clause, at 48. The commission is cognizant that the DSG Agreement is subject to certain conditions, including the commission's issuance of a decision and order that authorizes HECO's request in this regard. See DSG Agreement, Section 7.1, Regulatory Approval. Nonetheless, no action will be taken by the commission in this proceeding on HECO's request. Instead, HECO's request is deferred to future HECO rate case proceedings, see In re Hawaii Elec. Light Co., Inc., Docket No. 2008-0186, Decision and Order, filed on November 28, 2008, at 23 n.44; and In re Maui Elec. Co., Ltd., Docket No. 2008-0167, Decision and Order, filed on October 31, 2008, at 11 n.26, and with respect to its ECAC-related request, deferred to the electric utility's future application seeking the commission's approval of the fuel purchase agreement. See Section II.C, HAR § 6-60-6, of this Decision and Order.

> include the design, purchase, and installation costs of the State Equipment for DSG Use specified in Exhibit 1, and other HECO-approved DSG-related . . . State expenses required to enable DSG use such as DSG-related licenses, certificates, permits, and fees including, but not limited to, the air permit.

DSG Agreement, Exhibit 1, Paragraph 5.7 (emphasis in original).

> DSG Total Capital Expense Budget
>
> HECO's total not-to-exceed budget for reimbursement of the State's capital expenses . . . payable in accordance with Section 5.7 of this Agreement, is FOUR HUNDRED THOUSAND AND NO/100 DOLLARS (<u>$400,000). HECO will budget this sum for payments in calendar year 2009.</u>

DSG Agreement, Exhibit 4, Paragraph 5 (emphasis in original).

As explained by HECO: (1) in general, the purpose of its DSG Capital Expense Budget is to reimburse DOT Airports for equipment and construction costs that are directly attributable to allowing HECO to dispatch the EPF in parallel with the utility grid and for HECO's refueling responsibilities; (2) the subject equipment, while owned by DOT Airports, is funded by HECO "due to its DSG functionality[;]" and (3) primary examples of reimbursable DSG equipment capital costs include the fuel meters and taller engine stacks to enable the EPF to operate in compliance with the Covered Source Air Permit.[46]

According to HECO, "[w]hile not owned by HECO, this DSG Equipment is essential and necessary to allow HECO the ability to dispatch the EPF for DSG use over the term of the DSG Agreement. The reimbursement paid to DOT Airports for

[46] See Application, at 34, 36, 41, and 44-45; and HECO's response to CA-IR-2.a (the DSG Capital Expense Budget of $400,000 will reimburse DOT Airports for capital

the DSG equipment is essentially similar to an investment in equipment which HECO would be required to make to provide service to its customers."[47]

For accounting and ratemaking purposes, HECO proposes: (1) to record the DSG capital reimbursement in a deferred debit account (a regulatory asset) and include the unamortized balance of this regulatory asset in rate base; (2) to amortize the costs over the twenty-year term of the DSG Agreement, beginning in the month following the successful completion of the Acceptance Test; and (3) that "the annual amortization expense be included in determining HECO's revenue requirement in HECO's next rate making proceeding, and to include the unamortized balance of the regulatory asset . . . in rate base."[48] "Should DOT Airports terminate the DSG Agreement prior to its 20-year expiration date, DOT Airports would reimburse HECO for the cost of the Customer equipment based on the table presented in Exhibit 7 of the DSG Agreement. The unamortized deferred costs would be written off at the time the DSG Agreement is terminated."[49]

2.

Overhaul Cost Reimbursement

Pursuant to Exhibit 4, Paragraph 3 of the DSG Agreement, the engine overhaul cost reimbursement from HECO to

[47]Application, at 44.

[48]Application, at 45.

[49]Application, at 45.

DOT Airports shall not exceed $175,000 per engine ($700,000 for all four engines), subject to escalation beginning in 2010, based on the previous calendar year's GNPIPD index.

"Overhauls are required at 7,500 run hour intervals, with top end overhauls for the first two then a major overhaul at 22,500 run hours. Assuming HECO dispatches the EPF for DSG use and runs at its contractually allowed maximum of 1,500 hours, overhauls [will] be required every five years."[50] Due to the non-recurring and unpredictable nature of this significant "one-time" expense each time it is incurred, HECO contends that it will be difficult to normalize this cost for recovery in a rate case proceeding.

Accordingly, for accounting and ratemaking purposes:

> . . . . HECO proposes to record the <u>actual</u> overhaul cost reimbursement (subject to limitation as described), when <u>incurred</u>, in a deferred debit account (a regulatory asset) and include the unamortized balance of this regulatory asset in rate base. HECO proposes to amortize the costs over the lesser of a five year term, or the period remaining until the end of the [DSG] Agreement, beginning in the month following payment of the overhaul cost reimbursement. The five year amortization period is representative of the approximate interval of time between overhauls if the EPF is dispatched and run at the contractually allowed maximum of 1,500 hours per unit per year, as allowed under the DSG Agreement. Therefore, an amortization period of the lesser of five years or the period remaining until the end of the DSG Agreement would allow for recovery of the overhaul cost reimbursement prior to the incurrence of the next overhaul, which could possibly occur after five years, or the end of the DSG Agreement if an overhaul were to occur in the last few years of

[50]Application, at 46.

> the agreement. HECO proposes that the annual amortization expense be included in determining HECO's revenue requirement in HECO's next ratemaking proceeding, and to include the unamortized balance of the regulatory asset in rate base.

Application, at 47-48 (emphasis in original).

3.

Commission Action

HECO, in support of its dual requests, concludes by asserting:

> HECO requests Commission approval of the proposed accounting and ratemaking treatment of the DSG Capital Expense Budget and Overhaul Cost Reimbursement . . . . In order to maintain these costs in the deferred debit account, Commission approval of the proposed accounting and ratemaking treatment is required to provide assurance that the rates in the future will reflect the amortization of these costs. In the absence of Commission approval of the proposed accounting and ratemaking treatment, HECO would charge the described costs to expense as the costs are incurred. The Commission has previously allowed HECO to defer non-capital costs incurred by HECO in a deferred debit account, and to amortize the deferred debit cost to expense over time. In Decision and Order No. 13618 issued on October 31, 1994 in Docket No. 7277 (Waiau Water Well docket), and in Decision and Order No. 23514 issued June 27, 2007 in Docket No. 05-0146 (RO Water Pipeline docket) the Commission approved recovery of non-capital costs by HECO.

Application, at 48.

The Consumer Advocate, at this time, does not object to HECO's proposed ratemaking treatment of the costs associated with the DSG Project, subject to "its right to address the amount to be recovered from ratepayers at the time of [HECO's] next rate case proceeding."[51]

In In re Hawaiian Elec. Co., Inc., Docket No. 04-0113 ("Docket No. 04-0113"), HECO's 2005 test year rate case, the commission described HECO's average test year rate base as follows:

> Investors and non-investors provide the funds that are invested in the assets needed to provide reliable electric service. Funds provided by non-investors are deducted from investments in assets to determine the amount of investor-provided funds. The investor-funded portion of the investments in assets servicing customers is the amount on which investors are entitled to receive an opportunity to earn [a] fair return (i.e., rate base). Rate base therefore represents only the portion of investment in assets that is funded by investors.

Docket No. 04-0113, Decision and Order No. 24171, filed on May 1, 2008, at 64 (footnote and text therein omitted). In essence, consistent with well-settled ratemaking principles, HECO is entitled to earn a fair return on its investor-funded property that is deemed used and useful for electric utility purposes by the commission.[52]

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[51]Consumer Advocate's Statement of Position, at 11. At the same time, the Consumer Advocate does not mention or refer to HECO's proposed accounting treatment.

[52]See, e.g., HRS § 269-16(b)(provide a fair return on the property of the utility actually used or useful for public utility purposes); In re Puhi Sewer & Water Co., Inc., 83 Hawai'i 132, 137, 925 P.2d 302, 307 (1996)(the determination of a proper rate base thus entails a valuation of the utility's property devoted to public utility purposes upon which the utility is allowed to earn an appropriate rate of return); and Robert L. Hahne, Gregory E. Aliff, & Deloitte & Touche LLP, Accounting for Public Utilities, § 4.03 (2004)(under the "used and useful" concept, only plant currently providing or capable of

Here, for ratemaking purposes, HECO seeks to include in rate base the amounts it will reimburse DOT Airports for DSG capital costs of up to $400,000, pursuant to the electric utility's DSG Capital Expense Budget. HECO readily acknowledges that the subject equipment will be installed and owned by DOT Airports. Nonetheless, the installation of the subject equipment will enable HECO to dispatch the EPF in parallel operation mode, and thus, the associated costs will be funded by HECO due to the equipment's DSG functionality. HECO, in support of its request, reasons that "[t]he reimbursement paid to DOT Airports for the DSG equipment is essentially similar to an investment in equipment which HECO would be required to make to provide service to its customers."[53]

Here, it is undisputed that the subject DSG equipment is not HECO's utility-owned property. Yet HECO, in essence, seeks to: (1) impute in its rate base the DSG equipment installed and owned by DOT Airports; and (2) earn a return on equipment that it will not own. The commission rejects as unsupported and inconsistent with ratemaking principles HECO's imputed rate base theory. Accordingly, the commission denies as without merit HECO's proposed accounting and ratemaking treatments for the DSG Capital Expense Budget.

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providing utility service to the consuming public is allowed in the utility's rate base).

[53]Application, at 44.

For ratemaking purposes, HECO likewise seeks to include in rate base the amounts it will reimburse DOT Airports for the actual and reasonable engine overhaul costs, referred to as the Overhaul Cost Reimbursement in the DSG Agreement. HECO, in support of its request, contends that due to the non-recurring and unpredictable nature of this significant, one-time expenditure, "it would be difficult to 'normalize' this cost for recovery in a rate case proceeding."[54]

Here, the commission finds that HECO has not met its burden of proving that the Overhaul Cost Reimbursement constitutes a capital expenditure for ratemaking purposes, i.e., a property or asset that is used and useful for electric utility purposes. Instead, the docket record reflects that the costs associated with the Overhaul Cost Reimbursement constitute maintenance expenses. In support of this finding, the commission notes:

1. Pursuant to Exhibit 4, Section 3 of the DSG Agreement, "HECO will reimburse [DOT Airports] for the actual and reasonable costs of necessary engine overhauls during the term of [the] Agreement," and "[t]he determination of need and extent of the overhauls shall be based primarily on engine manufacturer recommendations."[55]

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[54]Application, at 47; see also HECO's response to CA-IR-14 (the overhaul cost reimbursement payment HECO is obligated to make has the potential to be a significant cost relative to the DSG Agreement, and non-recurring in nature, making it difficult to project and normalize for inclusion in a general rate case).

[55]DSG Agreement, Exhibit 4, Section 3, Overhaul Cost Reimbursement; see also HECO's response to CA-IR-14.b (the timing

2. HECO's Application, Exhibit 4, Operation & Maintenance Allowance Worksheets, states that "[o]verhaul costs are covered by an additional allowance as defined in Exhibit 4 of the DSG Agreement."[56]

3. "The Overhaul Cost Reimbursement was based on overhaul cost estimates provided by the Hawaii Caterpillar dealer, Hawthorne Power Systems. They estimated the cost of a major overhaul at $110,000 to $145,000 plus the possible cost of reinsulation of the generator windings for an additional $30,000, resulting in a potential total overhaul cost of $175,000."[57]

Indeed, the Overhaul Cost Reimbursement appears more analogous to the operating and maintenance expenses for the DSG Project described by HECO in Section XII.3.c, Operating and Maintenance Expenses for the Airport DSG Project, of its Application.[58]

Based on the foregoing reasons, the commission denies HECO's proposed accounting and ratemaking treatments for the Overhaul Cost Reimbursement.

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of the overhauls is dependent upon the engine manufacturer recommendations and the run hours of the unit).

[56]HECO's Application, Exhibit 4, Operation & Maintenance Allowance Worksheets, at 1.

[57]HECO's response to CA-IR-2.a (citing to Attachment 1 thereto).

[58]HECO's Application, Section XII.3.c, Operating and Maintenance Expenses for the Airport DSG Project (rate recovery will be requested for the revenue requirements resulting from the operating, maintenance, and monitoring costs for the Airport DSG Project, including the monthly DGI payment and Annual Routine Maintenance Allowance, in HECO's next general rate case).

III.

Orders

THE COMMISSION ORDERS:

1. HECO's request for a waiver of the DSG Project from the CB Framework is approved, pursuant to Part II.A.3.d of the framework.

2. The DSG Agreement, dated September 24, 2008, between HECO and DOT Airports, is approved, provided that the use of any fossil fuel for the EPF shall be limited to: (A) emergency mode operations by DOT Airports; or (B) parallel mode by HECO, if HECO obtains the commission's prior approval and contingent upon the electric utility's showing that there is a lack of reliable and cost effective supply of biodiesel and an essential need to run the EPF utilizing fossil fuel that could not reasonably be met with existing facilities.

3. HECO's request to commit funds for the DSG Project, currently estimated at $3.4 million (exclusive of customer contributions), is approved, pursuant to Section 2.3.g.2 of G.O. No. 7, as modified; provided that no part of the project may be included in HECO's rate base unless and until the project is in fact installed, and is used and useful for utility purposes.

4. HECO's proposed accounting and ratemaking treatments for the DSG Capital Expense Budget and the Overhaul Cost Reimbursement are denied.

5. Within sixty days from the completion of the DSG Project, HECO shall submit an accounting report with an explanation of any deviation of ten percent or more of the Project's estimated cost.

6. By February 28 of each year, HECO shall file with the commission an annual DSG Project status report that includes the following information based on the previous calendar year period: (A) EPF run hours; (B) estimated versus actual kW and kWh output of the EPF Generators; and (C) a summary of reimbursable maintenance and fuel costs.

7. The failure to comply with Ordering Paragraphs Nos. 5 or 6, above, may constitute cause to void this Decision and Order, and may result in further regulatory action as authorized by State law.

DONE at Honolulu, Hawaii JUN 25 2009.

PUBLIC UTILITIES COMMISSION
OF THE STATE OF HAWAII

By Carlito P. Caliboso
Carlito P. Caliboso, Chairman

By John E. Cole
John E. Cole, Commissioner

By
Leslie H. Kondo, Commissioner

APPROVED AS TO FORM:

Michael Azama
Michael Azama
Commission Counsel

2008-0329.laa

CERTIFICATE OF SERVICE

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

CATHERINE P. AWAKUNI
EXECUTIVE DIRECTOR
DEPARTMENT OF COMMERCE AND CONSUMER AFFAIRS
DIVISION OF CONSUMER ADVOCACY
P. O. Box 541
Honolulu, HI 96809

DEAN K. MATSUURA
MANAGER, REGULATORY AFFAIRS
HAWAIIAN ELECTRIC COMPANY, INC.
P. O. Box 2750
Honolulu, HI 96840-0001

THOMAS W. WILLIAMS, JR., ESQ.
PETER Y. KIKUTA, ESQ.
DAMON L. SCHMIDT, ESQ.
GOODSILL ANDERSON QUINN & STIFEL
Alii Place, Suite 1800
1099 Alakea Street
Honolulu, HI 96813

Counsel for HAWAIIAN ELECTRIC COMPANY, INC.