BEFORE THE PUBLIC UTILITIES COMMISSION

OF THE STATE OF HAWAII

----- In the Matter of -----)) PUBLIC UTILITIES COMMISSION)) Instituting a Proceeding to) Investigate Implementing a) Decoupling Mechanism for) Hawaiian Electric Company,) Inc., Hawaii Electric Light) Company, Inc. and Maui) Electric Company, Limited))	DOCKET NO. 2008-0274

FINAL DECISION AND ORDER

AND

DISSENTING OPINION OF LESLIE H. KONDO, COMMISSIONER

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FINAL DECISION AND ORDER

By this Final Decision and Order, the commission approves the decoupling mechanism proposed in the Joint Final Statement of Position of the HECO Companies and Consumer Advocate,[1] filed on May 11, 2009 ("Joint FSOP"), as

[1]The "HECO Companies" collectively refers to Hawaiian Electric Company, Inc. ("HECO"), Hawaii Electric Light Company, Inc. ("HELCO"), and Maui Electric Company, Limited ("MECO"); the "Consumer Advocate" refers to the Department of Commerce and Consumer Affairs, Division of Consumer Advocacy. The remaining parties to this proceeding are: the Department of Business, Economic Development, and Tourism ("DBEDT"), Haiku Design and Analysis ("HDA"), Hawaii Renewable Energy Alliance ("HREA"), Hawaii Solar Energy Association ("HSEA"), and Blue Planet Foundation ("Blue Planet"). In addition, Hawaii Holdings, LLC dba First Wind Hawaii ("First Wind") is a participant in this docket. The HECO Companies, Consumer Advocate, DBEDT, HDA, HREA, HSEA, and Blue Planet are collectively referred to as the "Parties."

amended by filings on June 25, 2009,[2] and July 13, 2009,[3] and as subsequently modified by the proposals in the HECO Companies' Motion for Interim Approval of a Decoupling Mechanism, filed on November 25, 2009 ("Interim Motion") (collectively, the "Amended Joint Proposal"), subject to the modifications made herein.

The HECO Companies' revenues shall be decoupled from sales[4] when rates that reflect a reduced rate of return ("ROR") due to decoupling are approved by the commission in either an interim or final decision and order in the HECO Companies' pending rate cases. The HECO Companies' tracking of target revenue and recorded adjusted revenue shall also take effect on the date of an interim or final decision and order in the HECO Companies' pending rate cases.[5]

---

[2]See HECO's Revised and New Exhibits for the Joint FSOP, filed June 25, 2009 ("June 25, 2009 Exhibits").

[3]See HECO's responses to Questions from Panel Hearings Held on June 29 to July 1, 2009, filed July 13, 2009 ("July 13, 2009 Responses").

[4]For the purpose of this Decision and Order, the term "sales decoupling" refers to the de-linking of utility revenues and profits from the volume of electric energy and capacity sold by the HECO Companies to the consumer.

[5]HECO began tracking target revenue and recorded adjusted revenue on February 20, 2010, "in order to align with the effective date of the tariff that implemented the commission's Second Interim Decision and Order, filed February 19, 2010 in HECO's 2009 test year rate case, Docket No. 2008-0083 ("Second Interim D&O")." Proposed Final Decision and Order filed by the HECO Companies and the Consumer Advocate on March 23, 2010 ("Proposed Final D&O") at 2. The commission, however, rules herein that tracking for the HECO Companies shall begin when the commission issues an interim or final decision and order wherein rates reflect a reduced ROR as a result of decoupling in the pending rate cases.

As acknowledged by all of the Parties to this docket, decoupling represents a transformational change from traditional rate-making. Under the traditional approach, utilities like the HECO Companies recover their fixed costs partially through fixed charges, such as customer charges, and partially through volumetric charges such as energy (or per kilowatt-hour ("kWh") charges). This rate design works for utilities when sales gradually increase from year to year, such that increases in revenues are sufficient to recover the fixed costs approved by regulators in the utility's last rate case, while also compensating the utility for cost escalation due to needed expansion or modernization of system infrastructure and inflation, all while maintaining an adequate return on the utility's investments to attract investors. The more a utility recovers its fixed costs from volumetric charges, the more a change in sales will affect earnings. Periods of consistent sales volume increases could lead to elevated earnings. Thus, utilities may have an incentive to increase sales, which could then lead to over-earnings.

In the event that sales become stagnant or are on a long-term decreasing trend, and the corresponding falling revenues fail to fully recover fixed costs, utilities traditionally initiate a rate case to request an increase in revenues. However, since rate proceedings may take many months

to adjudicate, it may be difficult for utilities to maintain their financial health. Under these conditions, it is not unusual for utilities to file rate cases in quick succession in an effort to reset their rates to compensate for falling sales and increasing costs.

For the HECO Companies, the conservation, energy efficiency, and customer-sited renewable generation measures that are advanced in Hawaii's recent energy policies and laws will contribute to falling sales. Thus, while these measures move the State toward important energy goals that all stakeholders and the commission support, the erosion of electricity sales and revenues may result in negative financial impacts to the HECO Companies. Decoupling, which de-links or "decouples" the HECO Companies' revenues from the amount of electricity or kWh they sell, is intended to remove the disincentive for the HECO Companies to aggressively pursue Hawaii's clean energy objectives.

The decoupling mechanism approved herein includes: (1) a sales decoupling component, or Revenue Balancing Account ("RBA"), which is intended to break the link between the HECO Companies' sales and their total electric revenue; and (2) a Revenue Adjustment Mechanism ("RAM"), which is intended to

compensate the HECO Companies for increases in utility costs and infrastructure investment between rate cases.[6]

While decoupling represents a new means of rate regulation and questions might still exist about the efficacy of decoupling, with the modifications to the decoupling mechanism and the protective measures approved herein, the commission believes that decoupling is the right regulatory model to move Hawaii toward a clean energy future, while also protecting the financial health of the HECO Companies.

I.

PROCEDURAL BACKGROUND

A.

Initiation of the Docket

By Order Initiating Investigation, filed on October 24, 2008 ("Opening Order"), the commission opened this docket to examine implementing a decoupling mechanism for the HECO Companies that would modify the traditional model of ratemaking for the HECO Companies by separating the HECO Companies' revenues

[6]HECO's most recently proposed RBA tariff provision, which was attached to the Proposed Final D&O, will sometimes be referred to as the "RBA Provision;" HECO's most recently proposed RAM tariff provision, which was attached to the Proposed Final D&O, will sometimes be referred to as the "RAM Provision." For ease of reference, to the extent that the equivalent provisions in MECO's and HELCO's tariffs are identical to HECO's, then those provisions in all of the HECO Companies' tariffs will be collectively referred to as the "RBA Provision" or the "RAM Provision." Additionally, unless otherwise specified, "decoupling" as used herein will generally refer to both the RBA and the RAM components of the Amended Joint Proposal.

and profits from electricity sales. In the Opening Order, the commission acknowledged that:

> On October 20, 2008, the Governor of the State of Hawaii, [DBEDT, the Consumer Advocate], and the HECO Companies entered into a comprehensive agreement designed to move the State away from its dependence on imported fossil fuels for electricity and ground transportation, and toward "indigenously produced renewable energy and an ethic of energy efficiency." A product of the Hawaii Clean Energy Initiative, the Agreement is a commitment on the part of the State and the HECO Companies to accelerate the addition of new, clean resources on all islands; to transition the HECO Companies away from a model that encourages increased electricity usage; and to provide measures to assist consumers in reducing their electricity bills.
>
> Included in the Agreement is a commitment by the HECO Companies to modify their traditional rate-making model by implementing a decoupling mechanism. Generally, decoupling is a regulatory tool designed to separate a utility's revenue from changes in energy sales. Decoupling, as asserted by its proponents, has the benefits of encouraging the substitution of renewable resources, distributed generation and energy efficiency for the utility's fossil fuels production (by reducing a utility's disincentive to promote these types of resources and programs), while simultaneously protecting a utility's financial health from erosion as these types of programs go into effect.[7]

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[7]Opening Order at 1-3 (footnote omitted). The Agreement refers to the Energy Agreement Among the State of Hawaii, Division of Consumer Advocacy of the Department of Commerce and Consumer Affairs, and the Hawaiian Electric Companies ("Energy Agreement"). It arose from the Memorandum of Understanding between the State of Hawaii and the U.S. Department of Energy to establish a partnership, called the Hawaii Clean Energy Initiative ("HCEI"), which aims to have 70% of all of Hawaii's energy needs generated by clean energy sources by 2030. The signatories to the Energy Agreement are the Governor of the State of Hawaii, DBEDT, the HECO Companies, and the Consumer Advocate. See Opening Order at 2 n.2.

In the Opening Order, the commission: (1) named the HECO Companies and the Consumer Advocate as parties to this proceeding; (2) directed them to file a joint proposal on decoupling within 60 days of the date of the order; and (3) directed them (and any intervenors and participants) to file a stipulated (or proposed) procedural schedule and a stipulated (or proposed) protective order within 45 days of the date of the order.

B.

Intervention

Motions to intervene were filed by (1) DBEDT, (2) HDA, (3) HREA, (4) HSEA, (5) Blue Planet, (6) First Wind, and (7) Life of the Land ("LOL"). The motions to intervene were approved by an order issued by the commission on December 3, 2008, which order also: (1) denied a motion by Tawhiri Power LLC for an enlargement of time to file a motion to intervene;[8] (2) dismissed as moot motions for leave to file reply memoranda that were filed by LOL, HDA, Blue Planet, and HREA on November 24, 2008, November 25, 2008, November 26, 2008, and December 1, 2008; and (3) extended certain deadlines that were addressed in the Opening Order. Thereafter, during the course of the docket, LOL withdrew

[8]On January 9, 2009, the commission issued an order denying a motion filed by Tawhiri Power LLC on December 15, 2008 for reconsideration of the order denying Tawhiri Power LLC's motion for enlargement of time.

from the proceeding and First Wind changed its status to "participant" in this proceeding.[9]

C.

Procedural Order

On January 21, 2009, the commission approved, with modifications, the proposed Stipulated Procedural Order submitted by the HECO Companies and the Consumer Advocate, as well as then-intervenors LOL, HREA, HDA, First Wind, DBEDT, HSEA and Blue Planet on December 26, 2008, pursuant to the Opening Order.[10]

In addition, on January 21, 2009, the commission issued a scoping paper titled, "Decoupling Utility Profits from Sales: Design Issues and Options for the Hawaii Public Utilities Commission" ("Scoping Paper"), prepared by the commission's consultant, the National Regulatory Research Institute ("NRRI").

The Statement of Issues initially approved by the commission in the Stipulated Procedural Order was as follows:

> 1. Whether the joint proposal or any separate proposals that are submitted by the HECO Companies, the Consumer Advocate or other parties are just and reasonable?
>
> 2. Whether the decoupling mechanism(s) will result in accelerating the addition of new, clean energy resources in the HECO Companies'

[9]On April 29, 2009, the commission issued an order granting a motion by First Wind to amend its status as an intervenor to a participant. On February 24, 2009, the commission issued an Order Approving Notice of Withdrawal, which approved LOL's withdrawal as a party in this docket.

[10]See Order Approving, with Modifications, Stipulated Procedural Order Filed on December 26, 2008, which was filed on January 21, 2009 ("Stipulated Procedural Order").

systems, while giving the HECO Companies an opportunity to achieve fair rates of return?

3. What should be the scope of and elements to be included in the decoupling mechanism?

4. How will decoupling impact the utilities, their customers, and the clean energy market?

5. Which issues and details regarding the implementation of the decoupling mechanism(s), including the determination of any revenue target, should be taken up in the context of individual rate case proceedings of HECO, HELCO and MECO?

6. Whether any cost tracking indices proposed for use in estimating revenue adjustment calculations can be expected to determine just and reasonable revenue adjustments on an on-going basis, accounting for the differences between the revenue requirement amounts determined in each utility's last rate case and:

   (a) The current cost of operating the utility;

   (b) Return on and return of ongoing capital investment; and

   (c) Any changes in State or federal tax rates.

7. Whether any earnings monitoring/sharing, service quality provisions, or any other adjustments or considerations are appropriate to implement as part of the decoupling methodology in order to calculate ongoing revenue adjustments that are just and reasonable?

8. Whether any provisions for administrative procedures (e.g., utility filings, decoupling tariffs, deferral accounting provisions, customer notice provisions, planned review/audit procedures and any appeal or hearing provisions) are appropriate, necessary and sufficient to ensure that post test year decoupling adjustments are fair and reasonable?

9. How many years should the decoupling/attrition revenue mechanism remain

in place for each of the utilities before the next rate cases are to be filed and under what conditions can the utility, the Commission or other parties initiate formal rate proceedings outside of such rate case intervals?

10. What accounting and regulatory reporting provisions are necessary to implement any decoupling provisions in a manner that will ensure reasonable definition, isolation and recovery of the types of costs that are to be separately tracked and charged to customers through other cost recovery mechanisms, such as Renewable Energy Infrastructure Program/Clean Energy Initiative, Energy Cost Adjustment Clause, Purchased Power, Demand Side Management, and other surcharge mechanisms?

11. Issues identified in the Commission's scoping paper in this docket.[11]

D.

Decoupling Proposals

On January 30, 2009, the HECO Companies and the Consumer Advocate each submitted decoupling proposals pursuant to the Stipulated Procedural Order, as supplemented by the HECO Companies' revised pages filed February 3, 2009.

In February 2009, the Parties submitted comments on and responses to questions raised in the Scoping Paper.

On February 27, 2009, a technical workshop was held to review the HECO Companies' and Consumer Advocate's decoupling proposals.

On March 30, 2009, a Joint Proposal on Decoupling and Statement of Position of the HECO Companies and Consumer Advocate

[11]Stipulated Procedural Order at 2-4.

("Initial Joint Proposal") was filed. A technical workshop and settlement discussion was held on April 20, 2009 in order to review the Initial Joint Proposal, along with alternative decoupling proposals and concerns submitted by HDA,[12] and by HREA.[13]

On May 11, 2009, the HECO Companies and Consumer Advocate filed their Joint FSOP, which included among other things (1) a RBA tariff provision, (2) a RAM tariff provision and (3) an energy cost adjustment clause ("ECAC") heat rate deadband proposal. Final statements of position were also filed on May 11, 2009 by HDA, Blue Planet, HSEA, DBEDT and HREA. Pursuant to discussions that took place during a June 22, 2009 prehearing conference, the HECO Companies and Consumer Advocate filed revised and new exhibits to their Joint FSOP on June 25, 2009.

From March through August 2009, the Parties exchanged and responded to information requests ("IRs") issued among the Parties (including IRs regarding the Joint FSOP), and also responded to IRs and additional questions issued by the commission.

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[12]HDA's proposal was submitted as part of its response to the Scoping Paper, Question #2, filed February 20, 2009.

[13]HREA's proposal was submitted as part of its response to the Scoping Paper, Question #2, filed February 20, 2009.

E.

Panel Hearing

Commencing on June 29, 2009, and ending on July 1, 2009, the commission held a panel-format evidentiary hearing, with Mr. Scott Hempling, Esq. moderating,[14] and Chairman Carlito Caliboso presiding with Commissioners John E. Cole and Leslie H. Kondo,[15] pursuant to the commission's June 16, 2009 Order Establishing Hearing Procedures for the panel hearings, which order replaced the issues identified for the docket in the Stipulated Procedural Order with the following issues:

I. Will Decoupling Help Achieve Hawaii's Objectives?

II. Decoupling Mechanics: How Well Does the HECO Companies' Decoupling Design Achieve Hawaii's Objectives?

III. Revenue Adjustment Mechanism: How Well Does it Achieve Hawaii's Objectives?

IV. Revenue Per Customer Mechanism and Other Alternatives: How Well Do They Achieve Hawaii's Objectives?

V. Energy Cost Adjustment Clause Amendment: What are Its Advantages and Disadvantages, In Terms of Hawaii's Objectives?

VI. What Review Processes and Safeguards Should the Commission Consider?

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[14]The commission retained Mr. Hempling, Executive Director of NRRI, as moderator of the panel hearing.

[15]Citations to the transcript of the panel hearing are as follows: Transcript of Proceedings ("Tr."), followed by the applicable volume number ("Vol. __") and page number(s), followed by the last name of the individual in parentheses. For example, "Tr. Vol. I at 34 (Hempling)."

On July 2, 2009, the commission issued its first of two interim decision and orders in Docket No. 2008-0083, HECO's 2009 test year rate case ("First Interim D&O"), which approved in part and denied in part HECO's request to increase its rates on an interim basis, as set forth in HECO's Statement of Probable Entitlement, filed in that docket on May 18, 2009. In particular, with respect to decoupling, the First Interim D&O noted that "[t]he commission has not yet determined that a sales decoupling mechanism and the establishment of HECO's proposed RBA are just and reasonable in the decoupling docket (Docket No. 2008-0274)" and accordingly "disallow[ed] any cost related to the implementation of the RBA at this time." First Interim D&O at 8.

By letter dated July 13, 2009 and in response to questions raised by the commission during the panel hearings, the HECO Companies provided additional information and submitted additional amendments to the Joint FSOP that had been agreed to with the Consumer Advocate but inadvertently overlooked for inclusion in the then proposed RAM tariff.

The Parties submitted opening briefs and reply briefs on September 8, 2009 and September 29, 2009, respectively, pursuant to an extension of time granted by the commission on August 7, 2009.

On November 25, 2009, the HECO Companies filed their Interim Motion and an attached Memorandum in Support of Motion

("HECO Memo in Support"), which proposed further modifications to the Joint FSOP. More specifically, the Interim Motion requested interim approval of:

> (1) the establishment and implementation by Hawaiian Electric of the revenue balancing account ("RBA") (with a slight modification, as shown in Attachment 1 [thereto], to include only one RBA account for all residential and nonresidential customers) to be effective January 1, 2010;
>
> (2) the establishment and implementation by Hawaiian Electric of the revenue adjustment mechanism ("RAM") (with modifications, as shown in Attachment 2 [thereto], (a) to refund to ratepayers (with interest) RAM revenues associated with disallowed costs for Baseline Capital Projects, and (b) to include an interim performance metric as described in Part III.F of the [HECO Memo in Support]) to be effective, beginning with calendar year 2010;
>
> (3) both the Hawaiian Electric RBA and RAM to remain in effect until interim rates become effective pursuant to an interim decision and order in Hawaiian Electric's 2011 test year rate case, provided that Hawaiian Electric:
>
> (a) does not file a 2010 test year rate case application, and
>
> (b) files its 2011 test year rate case application by August 16, 2010;
>
> (4) implementation by HELCO and MECO of the RBA and RAM (with slight modifications, as shown in Attachments 3-6 [thereto]) at such time as interim rates become effective pursuant to interim decision and orders in HELCO's and MECO's respective 2010 test year rate cases; and
>
> (5) the continuation of this proceeding for the primary purpose of evaluating the design and potential adoption of clean energy-related decoupling performance

> metrics, with final statements of position to be filed by the parties no later than June 30, 2010.[16]

Between December 3 and December 11, 2009, the Parties responded to the Interim Motion and the HECO Memo in Support in memoranda.

Rather than issuing an interim order in the docket, on February 19, 2010, the commission issued its order approving the Amended Joint Proposal, subject to the commission's issuance of a Final Decision and Order in this docket, and accordingly instructed the HECO Companies and Consumer Advocate to file a Proposed Final Decision and Order with joint proposed findings of fact and conclusions of law, as soon as practicable, but no later than 30 days from the date of the Order, for the commission's review and approval. All other parties were allowed to comment on the Proposed Final Decision and Order within five days of service or such other period ordered by the presiding officer pursuant to Hawaii Administrative Rules ("HAR") § 6-61-120(a).[17]

On March 23, 2010, the HECO Companies and the Consumer Advocate jointly filed their Proposed Final Decision and Order.

On March 31, 2010, HDA, HREA, and DBEDT filed comments on the Proposed Final Decision and Order.

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[16]Interim Motion at 1-3 (footnotes omitted).

[17]See Order at 2.

II.

DISCUSSION

A.

Amended Joint Proposal Summary

As modified by the June 25, 2009 Exhibits, July 13, 2009 Responses and the HECO Companies' Interim Motion, the key components of the Amended Joint Proposal applicable to each of the HECO Companies would include:

(1) a sales decoupling mechanism, which would be implemented through the RBA Provision;

(2) replacement of annual rate cases with a RAM, consisting of an operations and maintenance ("O&M") and other expense RAM component and a Rate Base RAM component, which is in the form of the RAM Provision; to coincide with planned triennial staggered rate cases for each of the HECO Companies to re-calibrate RAM inputs using commission approved values.[18]

(3) protection against excessive overall utility revenue levels through an Earnings Sharing Revenue Credit mechanism, which would be implemented through the RAM Provision;

(4) other consumer protection features in the RAM Provision (in addition to the Earnings Sharing Revenue Credit mechanism), including:

[18]The Amended Joint Proposal includes a proposal for a three-year decoupling cycle where rate cases are filed for test years that are three years apart. However, the HECO Companies explain that rate cases for all three companies are supported by the same regulatory department and the same witnesses for certain testimonies. Thus, in order to minimize the need for resources and be able to submit rate cases of the highest quality possible in the future, the Amended Joint Proposal contemplates that the rate cases after the initial decoupling cycle will be staggered so that three-year rate case cycles can commence thereafter for each company. The second decoupling cycle will begin with HECO's 2011 test year rate case, followed by either MECO's or HELCO's test year rate cases of 2012 and then MECO's or HELCO's test year rate cases of 2013.

a. a provision for Major Capital Projects Credits;

b. a provision for Baseline Capital Projects Credits;

c. notification provided to all affected customers of the RAM filing in newspapers and bills in a timely manner;

d. evaluation procedures for filing, examination and any exceptions to the annual RBA/RAM filings;

e. continued ability of the HECO Companies or the Consumer Advocate to initiate formal rate proceedings to replace and terminate RAM at any time on a schedule other than planned;

f. formal review, prior to continuation, termination or modification of decoupling, as part of the next round of the HECO Companies' rate case proceedings;

(5) a proposal to establish sales heat rate deadbands and provisions to reset the fixed sales heat rate factor in the ECAC; and

(6) the requirement of the HECO Companies to include a report on the status of certain HCEI initiatives in their next base rate cases.

B.

Issues

The HECO Companies and the Consumer Advocate maintain that the Amended Joint Proposal was designed to be responsive to the issues that were listed for consideration in this docket. Although the commission examines each of the issues separately, to the extent that the discussion in one section is applicable to

another section, this Decision and Order should be read in conjunction with, and in the context of, this entire Decision and Order.

1.

Whether Decoupling Will Help Achieve Hawaii's Objectives

The first issue in this docket is: "Will Decoupling Help Achieve Hawaii's Objectives?"[19]

a.

Hawaii's Objectives

The State's energy objectives and policies, as set forth in Hawaii Revised Statutes ("HRS") § 226-18, include a number of provisions relating to energy independence, renewable energy and energy efficiency:

> (a) Planning for the State's facility systems with regard to energy shall be directed toward the achievement of the following objectives, giving due consideration to all:
>
> > (1) Dependable, efficient, and economical statewide energy systems capable of supporting the needs of the people;
> >
> > (2) Increased energy self-sufficiency where the ratio of indigenous to imported energy use is increased;
> >
> > (3) Greater energy security and diversification in the face of threats to Hawaii's energy supplies and systems; and

[19]Order Establishing Prehearing Procedures at 5.

> (4) Reduction, avoidance, or sequestration of greenhouse gas emissions from energy supply and use.
>
> (b) To achieve the energy objectives, it shall be the policy of this State to ensure the short- and long-term provision of adequate, reasonably priced, and dependable energy services to accommodate demand.
>
> (c) To further achieve the energy objectives, it shall be the policy of this State to:
>
> (1) Support research and development as well as promote the use of renewable energy sources;
>
> * * *
>
> (4) Promote all cost-effective conservation of power and fuel supplies through measures, including:
>
> * * *
>
> (C) Adoption of energy-efficient practices and technologies;
>
> * * *
>
> (6) Support research, development, demonstration, and use of energy efficiency, load management, and other demand-side management programs, practices, and technologies;
>
> * * *
>
> (8) Support actions that reduce, avoid, or sequester greenhouse gases in utility, transportation, and industrial sector applications . . . .

The State's commitment to clean energy is also evident in legislation recently enacted, such as Act 155 of the 2009 Session Laws of Hawaii ("Act 155"), which increases the electric utilities' 2020 renewable portfolio standards ("RPS") requirement from 20% to 25%, and adds a new 40% requirement for the year 2030. Prior to January 1, 2015, at least 50% of a utility's

RPS must be met by "electrical energy generated using renewable energy as the source". After January 1, 2015, however, a utility's entire RPS will need to be met by renewable generation, and "electrical energy savings" will no longer count toward RPS requirements.[20]

In the Decision and Order Relating to RPS Penalties, issued December 19, 2008 in the RPS proceeding, Docket No. 2007-0008, the commission approved a discretionary penalty of $20 for every megawatt-hour ("MWh") that an electric utility is deficient under Hawaii's RPS law. Thus, an electric utility could be subject to penalties if it fails to meet the RPS standards.

In addition to increasing RPS requirements, Act 155 directs the commission to establish "energy-efficiency portfolio standards that will maximize cost-effective energy-efficiency programs and technologies." In particular, the legislation requires that the EEPS be designed to achieve 4,300 GWh of electricity use reductions statewide by 2030, with interim commission-established goals for 2015, 2020 and 2025. On March 8, 2010, the commission opened Docket No. 2010-0037, Instituting a Proceeding to Investigate Establishing Energy Efficiency Portfolio Standards, Pursuant to Act 155, Session Laws of Hawaii 2009 and Hawaii Revised Statutes § 269-96.

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[20] See Hawaii's RPS law, Title 15, Chapter 269, Part V, HRS. Beginning in 2015, electric energy savings will be counted toward energy efficiency portfolio standards ("EEPS"), which the commission is currently examining in Docket No. 2010-0037. See HRS § 269-96(e).

Furthermore, pursuant to HRS § 269-6(b), the commission "may consider the need for increased renewable energy use in exercising its authority and duties under this chapter."

Consistent with the foregoing policies and objectives, the signatories to the Energy Agreement acknowledged the need to "move decisively and irreversibly away from imported fossil fuel for electricity and transportation and towards locally produced renewable energy and an ethic of energy efficiency."[21] The Energy Agreement provides that the parties to the agreement will pursue a wide range of actions, including decoupling, with the purpose of decreasing the State of Hawaii's dependence on imported fossil fuels through substantial increases in the use of renewable energy and implementation of new programs intended to secure greater energy efficiency and conservation. At the same time, the Energy Agreement recognizes that a system of utility regulation will be needed to assure that Hawaii preserves a stable electric grid and a financially sound electric utility as vital components of the State's renewable energy future.[22] To that end, Section 28 of the Energy Agreement provides:

> Decoupling from Sales
>
> The transition to Hawaii's clean energy future can be facilitated by modifying utility ratemaking with a decoupling mechanism that fits the unique characteristics of Hawaii's service territory and cost structure, and removes the barriers for the utilities to pursue aggressive demand-response and load management programs, and customer-owned or third-party-owned

[21]Energy Agreement at 1.

[22]See id. at 1.

> renewable energy systems, and gives the utilities an opportunity to achieve fair rates of return. The parties agree in principle that it is appropriate to adopt a decoupling mechanism that closely tracks the mechanisms in place for several California electric utilities[.]

In sum, Hawaii's objectives are clearly laid out in the foregoing statutes and policies that aim to transition Hawaii from heavy reliance on imported fossil fuels to energy independence through increased promotion of renewable energy and energy efficiency.

b.

Decoupling Overview - Comparison to Traditional Ratemaking

Typically, utilities (like the HECO Companies) recover their fixed costs partially through fixed charges, such as customer charges, and partially through volumetric charges such as energy (or per kWh charges). This rate design works better for utilities when sales gradually increase from year to year, as increases in revenues may then be sufficient to recover the fixed costs approved by regulators in the last rate case, while also compensating the utility for: (1) cost escalation due to needed expansion or modernization of system infrastructure, service volumes and inflation, and (2) inflation in input prices for labor and services, all while (3) maintaining an adequate return on rate base to attract investors.[23] The more a utility recovers its fixed costs from volumetric charges, the more a change in

[23] See Revenue Decoupling Proposal of the Hawaiian Electric Companies, filed January 30, 2009, at 2.

sales will affect earnings. Periods of consistent sales volume increases could lead to elevated earnings. Thus, utilities may have an incentive to increase sales, which could then lead to over-earnings.

However, if sales are stagnant or are on a long-term decreasing trend, the falling revenues may not fully recover fixed or gradually increasing costs. This may lead to a decline in utility earnings and financial performance, and a reduction in the utility's capacity to invest in needed infrastructure to support reliability and public policy priorities such as renewable energy.[24]

Under traditional ratemaking, one of the conventional solutions to any declining sales and growing costs situation is to initiate a rate case. However, since rate proceedings usually take many months to adjudicate, utilities may seek to file rate cases in quick succession in an effort to reset their rates to compensate for falling sales and increasing costs.[25]

Conservation, energy efficiency, and customer-sited renewable generation will contribute to falling utility sales and, in turn, revenues, which may then result in negative financial impacts to utilities. Proponents of decoupling argue that de-linking (i.e., "decoupling") utility sales from utility revenues eliminates the disincentive to support and promote

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[24] See id. at 2-3.

[25] See id. at 3.

conservation, energy efficiency, and renewable generation that utilities face under traditional ratemaking.[26]

c.

Parties' Positions

As discussed below, the Parties generally agree that decoupling will help to achieve Hawaii's objectives.

HECO Companies

According to the HECO Companies, the Amended Joint Proposal is designed to overcome the disincentive to promote conservation, energy efficiency, and renewable generation by "de-linking" utility sales volumes from cost recovery.[27] In this regard, the HECO Companies submit that the purpose of the RBA Provision is to completely remove the linkage between utility sales and revenues, in order to encourage utility support for energy efficiency and the substitution of renewable resources. In essence, the RBA Provision is intended to provide a process to capture the difference between a target revenue requirement and actual billed revenues being collected, and to adjust rate levels (through an adjustment clause) to make up the difference.[28]

The HECO Companies explain that the purpose of the RAM Provision is to adjust revenues that have been decoupled from sales to also reflect changes in revenue requirements between rate cases, in order to help maintain the HECO Companies'

[26] See id. at 3.

[27] See id. at 2.

[28] See id. at 6.

financial integrity and ability to invest in the infrastructure necessary to meet Hawaii's 70% clean energy objective, while maintaining reliable service to customers. Additionally, the RAM Provision is intended to replace frequent rate case filings with calculated revenue changes to be effective between triennial scheduled future rate cases.

The HECO Companies further assert that the Amended Joint Proposal is intended to be consistent with the decoupling mechanism agreed to in the Energy Agreement.[29] While not binding upon the commission, the Energy Agreement describes many of the parameters of decoupling. The HECO Companies maintain that decoupling supports key energy policy objectives -

> by delinking revenues from sales through the sales decoupling mechanisms, and by allowing annual adjustments in the utilities' base revenues (in between regularly scheduled rate cases). Thus, decoupling properly and effectively aligns regulatory financial outcomes (i.e., incentives) with State Energy Policy.[30]

The HECO Companies also note that:

> The benefits of decoupling extend beyond the need for decoupling. Sales decoupling, by breaking the link between sales and earnings, eliminates the financial penalty incurred by utilities through cost-effective energy efficiency measures and customer-sited distributed renewable energy generation that reduce sales. Thus, sales decoupling encourages utility support for energy

[29] See HECO Opening Brief at 47-48.

[30] Id. at 6.

> efficiency measures and distributed renewable energy generation.[31]

In addition, the HECO Companies contend that decoupling will help to maintain "a financially sound utility that has the financial capability to maintain and invest in its infrastructure to accommodate increased renewable sources of energy" and "serve as a credit worthy off-taker of the planned renewable energy projects."[32]

Consumer Advocate

The Consumer Advocate, in its Opening Brief, states that "[t]he provisions of this Joint FSOP are designed to achieve Hawaii's objectives regarding just and reasonable rates, administrative simplicity and efficiency and protection of the financial health of the utilities as HCEI Agreement implementation occurs."[33] According to the Consumer Advocate:

> While annual rate cases may seem acceptable in spite of the tremendous costs and administrative burdens they impose upon Commission and Consumer Advocate resources, another problem is raised by maintaining the status quo form of regulation. The financial strength of the utility can be undermined by regulatory lag whenever costs are increasing more rapidly than they can be recovered through traditional rate case processes. The

[31]Reply Brief of Hawaiian Electric Company, Inc., Hawaii Electric Light Company, Inc., and Maui Electric Company, Limited, filed September 29, 2009 ("HECO Reply Brief") at 4.

[32]HECO Companies responses to NRRI Scoping Paper, Appendix 2 Questions, Question #6 at 1, filed February 20, 2009.

[33]Division of Consumer Advocacy's Post-Hearing Opening Brief, filed September 8, 2009 ("Consumer Advocate Opening Brief") at 13; see also Tr. Vol. III at 700-01 (Awakuni).

> HECO Companies must continue to invest in replacement plant to maintain reliability of existing infrastructure, while also raising capital to fulfill the substantial obligations they have accepted under the HCEI Agreement. The HECO Companies' access to capital on reasonable terms is essential to the ability of the state to pursue the HCEI objectives. Noting a stated objective in this Docket, "...to maintain the utility's ability to cover its prudent fixed costs so that it can attract capital on reasonable terms sufficient to fill its statutory obligations," the Consumer Advocate submits that a conservatively designed RBA/RAM mechanism is a better solution than continued frequent traditional rate cases during the implementation of the HCEI provisions.[34]

DBEDT

"DBEDT believes that a well designed decoupling [mechanism] will help achieve Hawaii's objectives. Decoupling helps remove the barriers to the utilities to aggressively promote and accommodate clean and renewable resources by ensuring utility cost recovery and reducing or eliminating regulatory lag."[35] According to DBEDT, "A decoupling mechanism will help reduce or eliminate this regulatory lag, thereby allowing the HECO Companies more timely cost recovery, and therefore facilitate their ability to deliver on their commitments in the Energy Agreement."[36] DBEDT, however, believes that

> [l]inking the decoupling mechanism that may be approved by the Commission in this docket

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[34]Consumer Advocate Opening Brief at 12-13.

[35]The Department of Business, Economic Development, and Tourism's Opening Brief, filed September 8, 2009 ("DBEDT Opening Brief") at 5.

[36]Id. at 9.

> to some measurable target performance goals will aid in evaluating the impact of such decoupling mechanism in achieving its intended goals and determining whether or not its continued implementation . . . is necessary and useful in achieving the state's goals.[37]

HDA

HDA's Opening Brief, in which HREA joins,[38] states that decoupling "would improve the alignment of the utilities' financial incentives with Hawaii's objectives to increase utilization of renewable resources, reduce consumption of fossil fuel and promote efficient use of energy."[39] According to HDA, decoupling "would also increase the stability of utility revenues and would thus promote the utilities' ability to attract capital."[40]

Blue Planet

Blue Planet's Opening Brief, in which HSEA joins,[41] states that,

> Blue Planet supports the adoption of sales decoupling with a [RAM] (together, "decoupling mechanism") in this proceeding

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[37]Id. at 10.

[38]See Hawaii Renewable Energy Alliance's Joinder to Haiku Design and Analysis's Post-Hearing Opening Brief Filed On September 8, 2009, filed September 8, 2009 ("HREA Joinder").

[39]Haiku Design and Analysis Opening Brief, filed September 7, 2009 ("HDA Opening Brief") at 10.

[40]Id. at 10.

[41]See Hawaii Solar Energy Association's Joinder to Blue Planet Foundation's Post-Hearing Opening Brief Filed On September 8, 2009, filed September 8, 2009 ("HSEA Joinder").

> that meaningfully and effectively aids in the achievement of Hawaii's energy objectives. Blue Planet respectfully submits that the Commission's decision in this proceeding should be guided by its evaluation of the extent to which the decoupling mechanism helps to achieve three major Hawaii energy objectives: (1) achievement of Renewable Portfolio Standards; (2) the rapid adoption of renewable energy and increased energy efficiency; and (3) increased public awareness and support for the decoupling mechanism, related Hawaii energy objectives, and Hawaii's swift transition to a clean energy economy.[42]

d.

Findings

Based on the record in this docket, the commission finds that decoupling will help to achieve Hawaii's objectives by eliminating the financial penalty incurred by utilities that successfully implement cost-effective energy efficiency measures and customer-sited distributed renewable energy generation that reduce sales. Decoupling also removes the incentive for the utilities to increase sales volumes in order to increase profits. While Hawaii could rely only on setting specific RPS mandates and other similar clean energy objectives, relying only on mandates may not yield the desired results. As suggested by the Parties, decoupling represents a possible means of enhancing Hawaii's commitment to wean itself from fossil fuels. Thus, decoupling supports the achievement of the RPS by the HECO Companies and

[42]Opening Brief of Blue Planet Foundation, filed September 8,2009 ("Blue Planet Opening Brief") at 1-2.

supports the EEPS. Decoupling also helps reduce or eliminate regulatory lag, thereby allowing the HECO Companies more timely cost recovery, which facilitates their ability to fulfill Hawaii's statutorily-mandated energy policy objectives. All Parties supported the adoption of decoupling in some form by the HECO Companies. Accordingly, while decoupling represents a new means of rate regulation and questions might still exist about the efficacy of decoupling, with the adoption of the protective measures described later, the commission finds that decoupling will improve the alignment of the HECO Companies' financial incentives with Hawaii's objectives to increase utilization of renewable resources, reduce consumption of fossil fuel, and promote efficient use of energy.

As discussed further below, however, while the commission declines to adopt performance metrics at this time, the commission emphasizes that it approves decoupling herein to remove any disincentive to the HECO Companies to implement energy efficiency and customer sited renewable energy, key components of the State's energy objectives. Stated differently, decoupling should incent the HECO Companies to fully support Hawaii's objectives. If, at any time, the commission finds in its judgment that decoupling is not achieving its intended purpose (or if the public interest so requires), the commission may reevaluate, suspend, or terminate, all or any portion of the decoupling mechanism.

2.

Ability of Sales Decoupling to Achieve Hawaii's Objectives

The second issue in this docket is: "Decoupling Mechanics: How Well Does the HECO Companies' Decoupling Design Achieve Hawaii's Objectives?"[43]

The Parties noted that alternative forms of decoupling, beyond those advanced in the Joint FSOP, have been employed in other jurisdictions. Certain proposed alternatives to the RBA/RAM approach are discussed separately in Section II.B.4 of this Decision and Order, while this Section focuses upon the Joint FSOP design relative to Hawaii's objectives.

a.

Sales Decoupling and RBA Details

Under the Amended Joint Proposal, sales decoupling will be implemented through the RBA Provision, through which the utility's revenues will be delinked from sales by setting the target revenues to the most recent authorized revenues approved in the utility's most recent rate case.[44] Accounting records will be maintained to record (1) the difference between the utilities' target revenue and recorded adjusted revenue, and (2) monthly interest applied to the simple average of the beginning and ending month balances in the RBA.[45]

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[43]Order Establishing Prehearing Procedures at 5.

[44]See HECO Opening Brief at 27.

[45]The accrual of interest is proposed at an annual rate of 6% - the same as that accrued on customer deposits and

As noted previously, the RBA target revenue will be the most recent Authorized Base Revenue[46] approved by the commission in an interim or final decision and order in a rate case, or the re-determined Authorized Base Revenue level, based on the additional annual amount of revenue required to recover certain costs calculated according to the RAM Provision since the most recent rate case, further adjusted to remove amounts for applicable revenue taxes and less any refunds due to the Earnings Sharing Revenue Credits, Major Capital Projects Credits or Baseline Capital Projects Credits.[47] The target revenue will

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specified in the HECO Companies' tariffs - applied to the simple average of the beginning and ending monthly RBA balances. This is an annual simple interest rate (i.e., one-twelfth of this rate will accrue per month). See RBA Provision at 2; HECO Opening Brief at 38.

[46]See HECO Opening Brief at 37. As further defined in the RAM Provision and discussed herein, "Authorized Base Revenue" represents the annual amount of revenue required for the utility to recover its estimated O&M, depreciation, amortization and tax expenses for the RAM Period, as well as the Return on Investment on projected rate base for the RAM Period, using the ratemaking conventions and calculations reflected within the most recent rate case decision and order issued by the commission.

[47]As further defined in the RAM Provision and discussed herein, "Earnings Sharing Revenue Credits" are the amounts to be returned to customers as credits through the RBA Provision, so as to implement the earnings sharing percentages and procedures described in the RBA Provision, commencing on June 1 of the calendar year containing the Annual Evaluation Date and over the subsequent 12 months after June 1;

"Major Capital Projects" are those capital investment projects that require application and commission approval under the commission's General Order No. 7, but excluding those Major Capital Projects included in the Renewable Energy Infrastructure Surcharge ("REIS");

"Baseline Capital Projects" are the total amounts of capital investment completed and closed to plant-in-service, excluding amounts related to Major Capital Projects and Baseline Capital

exclude revenues for fuel and purchased power expenses that are recovered either in base rates or in a Power Purchase Adjustment Clause ("PPAC"), as well as all other revenue being separately tracked or recovered through any other surcharge or rate tracking mechanism.[48]

The recovery section of the RBA Provision provides for collection or return of the accumulated calendar year-end balance in the RBA and for recovery of the RAM Revenue Adjustment[49] as described in the RAM Provision.[50] This recovery will occur

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Projects included in the REIS;

"Major Capital Projects Credits" are the amounts to be returned to customers through the RBA Provision, to reduce the preceding year's RAM Revenue Adjustment (including interest at the rate described in the RBA Provision) for specific major capital projects that were not placed into service within the first nine months of the preceding RAM Period as expected; and

"Baseline Capital Projects Credits" are the amounts to be returned to customers through the RBA Provision, to reduce the preceding year's RAM Revenue Adjustment (including interest at the rate described in the RBA Provision) for specific baseline capital projects that are disallowed by the commission in a subsequent rate case if the disallowance reduces actual Baseline Capital Projects costs below the Baseline Capital Projects cost estimate.

Authorized Base Revenue and the Earnings Sharing Revenue Credits mechanism are further discussed below in Sections II.B.3 and II.B.6 of this Decision and Order.

[48]See Joint FSOP at 10-11.

[49]As further defined in the RAM Provision and discussed herein, the "RAM Revenue Adjustment" represents the difference between the calculated Authorized Base Revenue for the RAM Period and either: (1) the previous year's calculated Authorized Base Revenue; or (2) the revenue requirement approved by the commission in an interim or final decision in the company's general rate case, whichever is more recent.

[50]See HECO Opening Brief at 36-38. As a further safeguard, the RBA mechanism provides that the target revenue will be

pursuant to detailed procedures set forth in the RBA and RAM Provision tariffs, as more fully described below.

The Amended Joint Proposal anticipates that on or before the Annual Evaluation Date of March 31st of each year[51] each company implementing decoupling will file with the commission a revision to its RBA Provision to reset the RBA rate adjustment[52] in accordance with the RBA and RAM Provisions[53] as an automatic rate adjustment clause. The proposed effective date will be June 1st, 61 days after filing, providing time for review. As required under HAR §§ 6-61-61 and 6-61-111, based upon the HECO Companies' filed schedules, the Amended Joint Proposal provides for a 47-day review period following the March 31st Annual Evaluation Date.[54] Thus, the Consumer Advocate and other parties will have up to the 15th day before the June 1st effective date of

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revised to correct for any errors in the calculation of the RAM Revenue Adjustment for any previous period to the extent that such errors are identified 15 days prior to the implementation date specified in the RAM Provision. See Joint FSOP at 25-26.

[51]As defined in the RAM Provision and further discussed herein, the "Annual Evaluation Date" is the date the company will make its annual filing under the RAM Provision. The RAM Provision states that the Annual Evaluation Date shall be no later than March 31 of each year, commencing March 31, 2010.

[52]As further defined in the RBA Provision and discussed below, the "RBA rate adjustment" or "RBA Adjustment" is comprised of the calculated values from the provision for recovery of balancing account amounts, adjusted to include amounts for applicable revenue taxes. The RBA rate adjustment is calculated based on the company's forecast of MWh sales over the RBA rate adjustment recovery period.

[53]See Joint FSOP at 24.

[54]This is 15 days before the effective date of the proposed RBA adjustment rate.

the tariff to file any protests. In the absence of any protests, the RBA rate adjustment, incorporating the RAM Revenue Adjustment, will be effective on June 1st.[55] The RBA Provision also allows revisions to correct for any errors in the calculation of the RAM Revenue Adjustment for any previous period, even if such errors are not discovered within the initial 47-day review period.[56]

As provided in the RAM Provision,[57] all affected customers will be notified of the filings via publication in newspapers of general circulation within 30 days of the filing and by notification with the HECO Companies' billing statements within 60 days after the filing has been made. In addition, the Amended Joint Proposal requires the HECO Companies to revise their RBA Rate Adjustments when necessary during the year to reset target revenues based on the commission's issuance of subsequent interim or final decision and orders in pending rate cases.[58]

The amortization of the previous calendar year-end balance in the RBA and the RAM Revenue Adjustment for the current calendar year, along with supporting calculations, will be recovered through a single per-kWh RBA rate adjustment for

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[55]The commission's current procedure is to confirm the effective date of tariffs filed with the commission in its monthly Tariff Order.

[56]See RBA Provision at 2, "TARGET REVENUE".

[57]See RAM Provision at 9-10.

[58]See Joint FSOP at 23.

residential and non-residential customers, over the 12 months from June 1st of the current calendar year to May 31st of the succeeding calendar year.[59]

Under the Amended Joint Proposal, a single target revenue level would be established for residential and non-residential customers. The HECO Companies and the Consumer Advocate state that the advantages of having only one RBA instead of two RBAs (i.e., residential and non-residential separately) as originally proposed include simplicity of administration, smoothing of customer impacts between rate cases and an allocation of costs that is a proxy for a revised cost-of-service study.[60]

Establishment of RBA Provisions

In its 2009 test year rate case, HECO requested the establishment of a RBA with the commission's issuance of the First Interim D&O to record the monthly differences between the approved interim revenue requirement and the recorded adjusted revenues as defined in the RBA Provision.[61] However, as discussed above in Section I.E of this Decision and Order, the commission's

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[59]See RBA Provision at 2-3.

[60]See HECO Memo in Support at 11. The Consumer Advocate concurred with this modification in its Reply Brief, and urges its inclusion in this Decision and Order. See Division of Consumer Advocacy's Comments on HECO's Motion for Interim Approval of a Decoupling Mechanism for Hawaiian Electric Company, Inc., Hawaii Electric Light Company, Inc., and Maui Electric Company, Limited, filed December 11, 2009 ("Consumer Advocate Comments") at 5.

[61]See Docket No. 2008-0083, Rate Case Update, HECO T-1, at 8-11.

First Interim D&O disallowed any mechanisms or expenses related to programs or applications that had not yet been approved at that time, including implementation of the RBA.[62]

MECO and HELCO also filed requests for the establishment of their RBA tariffs, along with proposed RAM Provisions, in their general rate increase applications for the 2010 test year in Docket Nos. 2009-0163 and 2009-0164, respectively.[63]

According to the HECO Companies and the Consumer Advocate, HECO began tracking target revenues and recorded adjusted revenues on February 20, 2010, based on the effective date of the tariff that implemented the Second Interim D&O in Docket No. 2008-0083 and the commission's approval of decoupling in the Order issued on February 19, 2010 in this proceeding.[64]

HECO anticipated filing its initial RBA Provision on March 31, 2010 to establish the RBA Adjustment rate to recover the December 31, 2009 RBA balance[65] and the calculated RAM Revenue Adjustment for 2010. The effective date of the RBA Adjustment

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[62]See First Interim D&O at 7-8.

[63]See MECO's Application, filed September 30, 2009, in Docket No. 2009-0163 at 2, 5; HELCO's Application, filed December 9, 2009, in Docket No. 2009-0164 at 2, 5. In addition, RBA and RAM tariff proposals for MECO and HELCO were submitted with the Proposed Final D&O in this docket.

[64]See Proposed Final D&O at 39.

[65]The HECO RBA balance at December 31, 2009 was "0", as the RBA had not been approved and established at that time.

rate would have been June 1, 2010, as reflected in the Joint FSOP.[66] HECO intended to designate the RAM Revenue Adjustment for the 2010 calendar year as interim, and subject to refund in the event the commission found a lower authorized base revenue amount to be reasonable for HECO's 2009 test year in its final decision and order in Docket No. 2008-0083.[67]

As for MECO and HELCO, the Amended Joint Proposal contemplates the establishment of RBAs for those companies to take place with the commission's authorization in their respective 2010 test year rate case interim orders. Similar to the timing for HECO, the Amended Joint Proposal allows for the initial RBA Provision filings for MECO and HELCO to take place on or before March 31st following the commission's interim decision and orders in the MECO and HELCO 2010 test year rate cases. The HECO Companies and Consumer Advocate represent that the proposed MECO and HELCO RBA Provisions are nearly identical to HECO's RBA Provision.[68] Like HECO's RBA Provision, the MECO and HELCO provisions would be applicable to all rate schedules in place at the time the RBA Provisions become effective.[69]

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[66]See Proposed Final D&O at 40.

[67]See id. at 40-41; see also Joint FSOP at 23. According to the HECO Companies and the Consumer Advocate, the difference between any lower authorized base revenue amount in a final decision and order in a rate case and a higher authorized revenue amount in an interim decision and order in a rate case will be refunded through rate mechanisms in the rate case. See Proposed Final D&O at 48 n. 90.

[68]See Proposed Final D&O at 41.

[69]See id.

Moreover, MECO and HELCO would follow the same filing and notice procedures described above for HECO, commencing after the interim decision and orders issued in their respective 2010 test year rate cases. Like HECO, the initial MECO and HELCO RBA and RAM Revenue Adjustments would be designated interim and subject to refund in the event that the commission finds a lower authorized base revenue amount to be reasonable for those test years in its final decision and orders.[70]

RBA Adjustment Supporting Documentation

In their annual RBA Adjustment filings on March 31st of each year, the HECO Companies plan to provide the schedules and supporting documentation for the calculation of all elements of the proposed rate change, including the amortization of accumulated RBA balances, calculations to implement the earnings sharing mechanism and RAM Revenue Adjustment as described in the RAM Provision.[71] RAM and earnings sharing calculations will be submitted concurrently as part of the RBA Adjustment filings for each utility, along with each company's calculation (with supporting documentation) of the historical five-year average of baseline and major capital projects' plant-in-service and contributions in aid of construction ("CIAC"), depreciation expense, and accumulated deferred income taxes ("ADIT").[72]

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[70]See Joint FSOP at 23-24.

[71]The RAM adjustment and earnings sharing are described in greater detail below in section II.B.3.a of this Decision and Order.

[72]See Joint FSOP at 25.

The data components for the filings will be the RBA balances to support the RBA rate adjustments and the company's annual earnings sharing and RAM Revenue Adjustment schedules identified in §§ 1 and 2 of the RAM Provision, respectively, as well as projected total company sales for the RAM Period.[73] Workpapers will also be provided that support the derivation and calculation of the monthly allocation factors and the per kWh charge.[74] Sources for this data will include actual and adjusted financial reports used for earnings review purposes; the documentation for plant additions, GDPPI and wage indices; and the interim or final decision and orders from the HECO Companies' rate proceedings.

Bill Presentation of RBA Adjustments

The Amended Joint Proposal calls for a single per kWh decoupling adjustment for both residential and non-residential customers. The dollar value of such per kWh adjustments can be presented as a separate line item on the customer bill, can be combined with a particular bill component on the customer bill, or can be reflected within each bill component on the customer bill. The HECO Companies have stated that the existing billing system cannot practically accommodate a line item for a decoupling adjustment for each bill component on the customer

[73]As defined in the RAM Provision and further discussed below, the "RAM Period" is the calendar year containing the annual evaluation date.

[74]See Joint FSOP at 25.

bill, and even if it could, such a bill presentation would be unduly complex and likely confusing to most customers.[75] Accordingly, the Amended Joint Proposal proposes to present a single decoupling adjustment as a separate line item on customer bills for purposes of simplicity and transparency.[76]

b.

Parties' Positions

As pointed out by the Consumer Advocate, all Parties to the docket are supportive of the basic decoupling concept and no Party appears to object to the proposed RBA Provision in the Joint FSOP.[77] The issues that were raised by the Parties other than the Consumer Advocate and the HECO Companies were primarily focused upon details of the RAM provision, alternatives to the RAM, the ECAC, and Energy Agreement performance measures, rather than on any specific concerns with the pure decoupling accomplished by the RBA provision.

With respect to HECO, the HECO Companies state that if the commission were to order the establishment of the RBA, HECO's target revenues would be based on a rigorously reviewed test year that is the most current possible, the 2009 test year.[78] As a result, the authorized rates will have been determined to be just

[75]See id. at 26-27.

[76]See id.

[77]See Consumer Advocate Opening Brief at 16.

[78]HECO has since filed a 2011 test year rate case.

and reasonable for both HECO and ratepayers with the commencement of decoupling as well as the monthly allocation of the target revenue, since it will be based on the test year sales forecast that has been determined by the commission to be reasonable. According to the HECO Companies, with the commission's finding that the target revenue, authorized rates and sales forecast have been reasonably determined, there should be little bias in the development of the RBA accumulated balance.[79]

With respect to MECO and HELCO, the HECO Companies and the Consumer Advocate assert that the merits of using the most recently authorized revenue requirements, as stated above, also apply. Additionally, the HECO Companies note that "if the Commission were to order the immediate establishment of the RBA and RAM for MECO and HELCO with the issuance of the interim decision and orders for their 2010 test year rate cases, as noted by HDA, 'the sensitivity of the determination of the test year sales and demand forecasts as substantial contested issues' would be eliminated."[80]

The Consumer Advocate discusses other advantages of the RBA:

> [T]he RBA will stabilize the HECO Companies' margin revenues. One benefit of revenue stabilization is the protection of the HECO Companies' financial condition and ability to access capital markets on reasonable terms. Another benefit from decoupling revenue stabilization is the reduction in business risks faced by the HECO Companies after sales

[79] See HECO Memo in Support at 9-10.

[80] Id. at 10 (citing HDA Opening Brief at 8 n.7).

> volume risks are shifted to ratepayers, which serves to rationalize a lower authorized return on equity for the utility in future rate cases. Next, it should be noted that decoupling is beneficial in eliminating the need in rate cases to accurately predict future test year sales volumes and revenues, because any inaccuracies in such predictions are self-correcting through the RBA account. Finally, by making the HECO Companies indifferent to changes in future sales volumes, decoupling removes any perceived business disincentive to fully support the deployment of renewable resources, [distributed generation] or expanded conservation measures. In all of these ways, revenue decoupling and the RBA provision serve to complement the State's objectives set forth in the HCEI Agreement.[81]

c.

Findings

Based on the record in this docket, and there being no objection to the RBA by the Parties, the commission finds approval of the RBA Provision to be in the public interest for several reasons. The RBA Provision will encourage utility support for energy efficiency and renewable resources by making the HECO Companies indifferent to changes in future utility sales volumes. By stabilizing the HECO Companies' revenues, sales decoupling will help to protect the HECO Companies' financial condition, and should result in less frequent rate cases. With the anticipated need for greater capital investments to allow the greater penetration of renewable resources, the RBA is also in the public interest to reduce the cost and burden of the more frequent rate case filings that would be required without

[81]Consumer Advocate Opening Brief at 14-15.

decoupling, which consume significant resources that must also be recovered from ratepayers.

Because the RBA would have the effect of stabilizing revenues for each of the HECO Companies at commission-approved levels, deviations in actual sales relative to test year estimates would not contribute to either over- or under-recovery of intended revenue amounts. Thus, the design of the RBA appears revenue neutral since, although the RBA may periodically be positive or negative, over the long-run, the RBA should not bias rates upwards or downwards. Rather, any rate impacts of the RBA should be short-term, and should be in the direction and general order of magnitude as those that would result from prompt rate cases.

There was general agreement in this docket, and in HECO's 2009 test year rate case docket (Docket No. 2008-0083), that decoupling would have the effect of reducing the HECO Companies' financial risk.[82] As such, the ROR on equity should factor in the effects of decoupling for each of the HECO Companies. With a lowered ROR, and the other ratepayer protections (i.e., Earnings Sharing Revenue Credits) discussed below, the decoupling mechanism should operate fairly to both the HECO Companies and their ratepayers. In the event that any inappropriate recovery of costs results from decoupling, the

[82]In Docket No. 2008-0083, one of the contested issues was the effect of various cost recovery mechanisms contemplated in the Energy Agreement (i.e., the decoupling RBA and RAM mechanisms, PPAC, and the REIS). HECO's ROR was also explored in great detail during the evidentiary hearing in that docket held on October 26, 2009 through November 6, 2009.

commission has the authority to unilaterally discontinue the decoupling mechanism, as discussed in Section II.B.6, infra.

Accordingly, the commission finds that the RBA Provision reasonably and fairly implements decoupling (see the commission's findings in Section II.B.1.d above), is just and reasonable, and achieves Hawaii's energy objectives.

The HECO Companies shall implement decoupling, and commence tracking target revenues and recorded adjusted revenues when rates that reflect a reduced ROR due to decoupling are approved by the commission in either an interim or final decision and order in the HECO Companies' pending rate cases.

The commission finds the timing for annual tariff filings by March 31st, and the evaluation and notice procedures in the RBA Provision to be reasonable, and approves those measures. However, related to the Consumer Advocate's review of the HECO Companies' annual tariff filings, the commission determines that a Statement of Position filed by the Consumer Advocate would be helpful to assist the commission in its own review of the tariff filings and supporting workpapers. The commission accordingly directs the Consumer Advocate to file a Statement of Position within 30 days after the HECO Companies make their RBA Provision filings, unless otherwise ordered by the commission. The Consumer Advocate's Statements of Position should describe the Consumer Advocate's review of the filings, and note any objections or concerns it has with the filings.

While the commission recognizes that the review process for the annual RBA and RAM Provision filings will be more akin to the review of tariff filings, and will not entail the rigorous review given to rate cases where the HECO Companies have the burden of proving that their requested revenue increases are prudent and reasonable, the commission nevertheless intends to carefully review the HECO Companies' annual tariff filings, particularly during the early implementation stages of decoupling.[83] Accordingly, as addressed further below in relation to the RAM Provision, the decoupling mechanism should not be viewed as a guaranteed, automatic pass-through of utility costs to ratepayers. The commission expects that, even with decoupling, the HECO Companies will still be incented to prudently manage their costs (i.e. contractual labor increases). If the commission finds anything objectionable with the HECO Companies' annual tariff filings, it has the authority to suspend the tariff.[84] In this regard, the commission directs the HECO Companies to include the commission's explicit authority to suspend the RBA and RAM in the tariffs.

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[83]For this reason, the Consumer Advocate's Statements of Position on the annual filings will be helpful to the commission.

[84]Or more broadly, as discussed in Section II.B.6, if the commission finds that the decoupling mechanism is not operating in the public's interest, it has the authority to reevaluate the mechanism or terminate the mechanism, in whole or in part, at anytime.

3.

Ability of the RAM to Achieve Hawaii's Objectives

The third issue in this docket is: "Revenue Adjustment Mechanism: How Well Does it Achieve Hawaii's Objectives?"[85]

a.

RAM Details

The second key component of the Amended Joint Proposal is a RAM provision that would serve to replace annual rate cases with formula-driven estimates of utility revenue requirements.[86] The HECO Companies and the Consumer Advocate designed the RAM Provision "to re-determine annual utility authorized base revenue levels, thus providing for conservatively quantified estimated changes in the utility's cost to provide service."[87] If it is determined through the RAM Provision formulae that annual utility Authorized Base Revenues should be decreased or increased, then the Authorized Base Revenue level applicable within the RBA Provision will be adjusted as set forth in the RAM Provision. The RAM Revenue Adjustments implemented under the RAM Provision will therefore escalate and update the HECO Companies' approved base revenue requirements through use of updated actual financial data and cost indices, reduced by any

[85]Order Establishing Prehearing Procedures at 6.

[86]See Consumer Advocate Opening Brief at 17.

[87]Proposed Final D&O at 51.

Earnings Sharing Revenue Credits, Major Capital Projects Credits or Baseline Capital Projects Credits to customers.[88]

The "Authorized Base Revenue" under the RAM will be the annual amount of revenues required for the utility to recover its estimated O&M, depreciation, amortization and tax expenses for the RAM Period, as well as the Return on Investment[89] on projected rate base for the RAM Period (referred to as the "Rate Base" in the RAM Provision), using the ratemaking conventions and calculations reflected within the most recent rate case decision and order issued by the commission, as quantified in the manner prescribed in the RAM Provision. The RAM Period is defined as the calendar year containing the Annual Evaluation Date (i.e., the date the utility makes its annual filing under the RAM mechanism).

The components of a company's revenue requirement that are subject to update and escalation through the RAM Provision include the revenue requirements associated with: (1) changes in designated labor and non-labor O&M and payroll tax expenses (referred to as "Base Expenses" in the RAM Provision); (2) the return on incremental investment in designated Rate Base components; (3) updated depreciation and amortization expenses;

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[88]The role of major and baseline capital projects credits as a customer safeguard is further discussed below in Section II.B.6.c of the Decision and Order.

[89]As defined in the RAM Provision and further discussed herein, "Return on Investment" is the overall weighted percentage rate of return on debt and equity capital approved by the commission in the most recent rate case.

and (4) changes in costs due to significant changes in tax laws or tax regulations (referred to as "Exogenous Tax Changes" in the RAM Provision).[90]

Base Expenses

Base Expenses include the labor and non-labor O&M expense amounts approved by the commission in the most recent rate case where the test year was the Evaluation Period,[91] or alternatively, as authorized by the commission in its Tariff Order for the immediately preceding year RAM Period if the Evaluation Period is not a test year. Base Expenses do not include any fuel, purchased power, integrated resource planning ("IRP")/demand-side management ("DSM"), pension, post retirement benefits other than pensions, or clean energy/renewable energy infrastructure costs that are subject to recovery through separate rate tracking mechanisms.[92] As a result, these excluded costs will be carried forward into the RAM Period without adjustment, at the fixed amounts established in the most recent rate case proceeding, because changes in these costs are accounted for separately in other cost tracking mechanisms.[93]

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[90] See Joint FSOP at 13.

[91] As defined in the RAM Provision and further discussed below, the "Evaluation Period" is the historical twelve month period ending December 31, of each calendar year preceding the Annual Evaluation Date. The Evaluation Period is used to determine achieved earnings and any sharing of such earnings above the Authorized Return on Equity, as well as the year-end recorded balances of Plant-in-Service, Accumulated Depreciation, ADIT, and CIAC for the beginning of the RAM Period.

[92] See Joint FSOP at 14.

[93] See id. at 13-14.

Base Expenses will be segregated between labor and non-labor amounts, with the labor component quantified for the RAM Period by application of the Labor Cost Escalation Rate[94] that is reduced by the Labor Productivity Offset[95] and the non-labor components quantified for the RAM Period by application of the Non-labor Cost Escalation Rate.[96] According to the HECO Companies and the Consumer Advocate, the purpose of using these escalation rates is to track only inflation on the costs approved in the last rate case proceeding, while assuming that improved management efficiency measures will serve to offset increasing wage costs. The RAM does not account for any staffing level changes (for example, costs associated with the hiring of additional employees or consultants) that are not reflected in the most recent rate case.[97]

The Amended Joint Proposal proposes that the labor component of Base Expenses, including payroll taxes, will be

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[94]The RAM Provision defines the "Labor Cost Escalation Rate" as the applicable annual percentage general wage rate increase provided for in currently effective union labor agreements for use in escalating wage and salary Base Expenses for both union and non-union employees to determine the RAM Revenue Adjustment for each RAM Period.

[95]As defined in the RAM Provision and further discussed herein, the "Labor Productivity Offset" shall be fixed at 0.76% and will be subtracted from the Labor Cost Escalation Rates applicable to Base Expenses to determine the authorized RAM Revenue Adjustment for each RAM Period.

[96]As further defined in the RAM Provision and discussed herein, the "Non-labor Cost Escalation Rate" is the consensus estimated annual change in the Gross Domestic Product Price Index ("GDPPI") to escalate non-labor Base Expenses to determine the RAM Revenue Adjustment for each RAM Period.

[97]Proposed Final D&O at 54-55.

quantified for the RAM Period by application of the Labor Cost Escalation Rate, reduced to account for the productivity offset to labor expenses. The Labor Cost Escalation Rate is intended to be the applicable annual percentage general wage rate increase provided for in currently effective International Brotherhood of Electrical Workers ("IBEW"), Local 1260 union labor agreements for use in escalating wage and salary Base Expenses for both union and non-union employees to determine revenue requirements for the RAM Period. In the event no IBEW Local 1260 union labor agreement exists for a RAM Period, the most recently effective annual percentage general wage rate increase will apply.[98]

The annual Labor Productivity Offset is fixed at 0.76% and will be subtracted from the Labor Cost Escalation Rate applicable to the labor components of Base Expenses to determine revenue requirements for the RAM Period.[99] This productivity estimate for the HECO Companies was submitted in Docket No. 99-0396[100] and was accepted as reasonable in the Joint FSOP as a proxy for achievable productivity gains until updated studies can be performed.

The non-labor component will be quantified for the RAM Period by application of the Non-labor Cost Escalation Rate. The

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[98] See Joint FSOP at 14.

[99] See id.

[100] See Application of Hawaiian Electric Company, Inc., Hawaii Electric Light Company, Inc., Maui Electric Company, Limited for approval to implement performance based ratemaking in their next respective rate cases, Docket No. 99-0396, filed December 13, 1999, at 6.

Non-labor Cost Escalation Rate will be the consensus estimated annual change in the GDPPI.[101] No productivity offset is applied to the Non-labor Cost Escalation Rate because GDPPI is a measure of national output price inflation that includes the impact of embedded productivity. The application of a further productivity offset would thus double-count the impact of productivity.[102]

Rate Base

The Rate Base (for the RAM Period) will be the average net investment estimated for the RAM Period, including each of the elements of rate base reflected within the most recent rate case decision and order issued by the commission. The Authorized Base Revenue associated with Rate Base will be determined by multiplying the applicable Return on Investment percentage rate times the Rate Base. The Authorized Base Revenue associated with Return on Investment, as previously approved by the commission, will include related income taxes on the equity components and related revenue taxes on all components of such return. The quantification of Rate Base is specified in greater detail in § 2(f) of the RAM Provision. In effect, the average rate base for the RAM Period (i.e., the Rate Base) will be the same rate base for the previous rate case test year, with adjustments for changes to update only four major components of the rate base, including (1) average plant-in-service, (2) depreciation reserve

[101]Published by the Blue Chip Economic Indicators (Aspen Publishing), issued in February of the year of the RAM filing.

[102]See Joint FSOP at 14-15.

(i.e., "Accumulated Depreciation"), (3) accumulated CIAC and (4) ADIT. All other components of the rate base will remain the same as those approved in the preceding rate case test year rate base.[103]

The average plant-in-service amount will be equal to the average of (1) the actual, recorded plant-in-service balance as of the end of the year prior to the RAM Period (termed the "Evaluation Year") limited to cost levels approved by the commission, and (2) the same Evaluation Year year-end balance plus estimated plant additions for the RAM Period. Estimated plant additions for the RAM Period will be set at the sum of Baseline Capital Project plant additions plus Major Capital Project plant additions estimated to be in service by September 30th of the RAM Period.[104]

Baseline Capital Projects include the total amounts of capital investment completed and closed to Plant-in-service, excluding amounts related to Major Capital Projects. Baseline Capital Project plant additions for the RAM year will be calculated based on the simple average of Baseline Capital Projects plant additions recorded in the immediately preceding five calendar years.[105] There is no inflation factor applied to restate the amount for the current RAM period, which according to

[103] See id. at 15-16.

[104] See id. at 16.

[105] See id. at 16.

the HECO Companies and the Consumer Advocate, results in a fairly conservative estimate of Baseline Capital Project plant additions.

Major Capital Projects include capital investment projects ("CIP") that require application and commission approval to commit funds pursuant to Decision and Order No. 21002, filed May 27, 2004 in Docket No. 03-0257 ("D&O 21002") "For Exemption From and Modification of General Order No. 7, Paragraph 2.3 (g), Relating to Capital Improvements."[106] However, if specific Major Capital Projects are to be included in the REIS, they will not be included within the RAM Provision, so as to avoid any double recoveries.[107] The Amended Joint Proposal proposes that, for purposes of calculating the Rate Base for the RAM, the costs of Major Capital Projects will be limited to those amounts most recently approved, e.g., when authorized in the commission's decision approving the HECO Companies' application in compliance with General Order No. 7 or in an interim or final decision and

[106]D&O 21002 revised Paragraph 2.3(g)(2) of General Order No. 7 to read "Proposed capital expenditures for any single project related to plant replacement, expansion or modernization in excess of $2,500,000 excluding customer contributions, or 10 per cent of the total plant in service, whichever is less, shall be submitted to the Commission for review at least 60 days prior to the commencement of construction or commitment for expenditure, whichever is earlier."

[107]See Joint FSOP at 16.

order issued by the commission in the HECO Companies' rate cases.[108]

Accumulated Depreciation at December 31st of the RAM Period is quantified by increasing the recorded balances at December 31st of the Evaluation Period by the RAM Period depreciation and amortization expense amount.[109]

CIAC is quantified by adding to the recorded balance at December 31st of the Evaluation Period an estimate of the net change in CIAC for the RAM Period. The net change will be based on (1) a simple average of cash and in-kind CIAC for Baseline Capital Projects for the immediately preceding five calendar years, and (2) specific engineering estimates of any contributions for the Major Capital Projects that are added

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[108]The HECO Companies and the Consumer Advocate note here that:

> In the case of HECO's East Oahu Transmission Project ("EOTP") that is planned to be placed into service in 2010, it also was noted in the Companies' Revenue Decoupling Proposal, filed January 30, 2009 at 27 n.12, that pre-2003 planning costs (and the related Allowance for Funds Used During Construction) would not be included in the rate base RAM beginning of year balance, as a result of the October 28, 2005 stipulation between HECO and the Consumer Advocate reached in the EOTP proceeding, Docket No. 03-0417. This agreement is now part of the Amended Joint Proposal.

Proposed Final D&O at 59 n. 113. As discussed further below, the commission rules that similar limits should be placed on the inclusion in the rate base RAM of costs for HECO's Campbell Industrial Park Combustion Turbine Unit 1 ("CIP CT-1") Project that were reached in settlement in HECO's 2009 test year rate case, Docket No. 2008-0083.

[109]See Joint FSOP at 17.

to rate base during the RAM Period, less (3) an estimate of the amortization of CIAC for the RAM Period.[110]

ADIT is quantified by adding to the recorded balances at December 31st of the Evaluation Period the estimated tax effect of the depreciation timing difference (i.e., difference between book depreciation and tax depreciation) on the Baseline Capital Projects estimated to be added to rate base during the RAM Period and on the Major Capital Projects estimated to be added to rate base by September 30th of the RAM Period.[111]

Depreciation and Amortization Expenses

Depreciation and amortization expenses will be quantified for the RAM Period by application of commission-approved accrual rates to the actual recorded and RAM Rate Base-includable Plant-in-service (or other applicable) and CIAC balances at the end of the Evaluation Period.[112]

Exogenous Tax Changes

Exogenous Tax Changes will only be recognized for changes in tax laws or tax regulations that are estimated to impact Authorized Base Revenues by $2,000,000 or more for HECO, or $500,000 or more for HELCO or MECO.[113]

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[110] See Joint FSOP at 17; June 25 2009 Exhibits, Exhibit C, Attachment 6 at 2.

[111] See id.

[112] See id.

[113] See id.

Major Capital Projects Credits

Major Capital Projects Credits are amounts that will be returned to customers as credits through the RBA for the preceding years' authorized base revenue amounts (including interest at the rate described in the RBA Provision) associated with specific major projects that were ultimately not placed into service within the first nine months of the preceding RAM period or if the commission ultimately disallows any Major Capital Project costs in a subsequent review. The HECO Companies and the Consumer Advocate explain:

> One purpose of these credits is to ensure that ratepayers are not paying for capital projects that have not been placed into service within the cutoff period ending September 30th of the RAM period.
>
> Also, questions were raised during this proceeding's panel hearings regarding the use of actual plant balances for the beginning of year balances in the RAM, since there would be no completed review of the reasonableness of cost overruns in the case of Major Capital Projects, or project costs in the case of Baseline Capital Projects. Additionally, because the commission's review of Major Capital Projects may not occur until the rate case after such capital projects are included in one or more RAM Revenue Adjustment filings, customers will be refunded (with interest) any prior collection of RAM amounts associated with Major Capital Projects costs that the commission may subsequently disallow for rate recovery. This ensures that only authorized amounts for Major Capital Projects are paid for by ratepayers.[114]

[114]Proposed Final D&O at 61-62 (citing Tr. Vol. II at 311-29, 494-99 (Hempling, Hee, Lee, Young, Kondo, Carver, Brosch); Tr. Vol. III at 530-35 (Kondo, Hee)).

Baseline Capital Projects Credits

Similar to Major Capital Projects Credits, Baseline Capital Projects Credits are amounts that will be returned to customers as credits through the RBA for the preceding year's authorized base revenue amounts (including interest at the rate described in the RBA Provision) associated with specific Baseline Capital Project costs that are disallowed by the commission in a subsequent rate case. This credit will apply if any plant cost disallowance ordered by the commission reduces actual Baseline Capital Projects costs below the Baseline Capital Projects Plant in Service cost level included in RAM Rate Base. Thus, the Baseline Capital Projects Credit may reflect the impact for multiple RAM Periods of the disallowance ordered by the commission on the calculation of the simple historical five-year average of Baseline Capital Projects cost estimates and/or the disallowance impact upon recorded Plant in Service balances. Because the commission's review of Baseline Capital Projects may not occur until the rate case after such Baseline Capital Projects are included in one or more RAM Revenue Adjustment filings, Baseline Capital Projects Credits will be used to refund to customers any prior collection (i.e., Return on Investment on rate base and depreciation, plus interest) relating to the amount of Baseline Capital Projects costs that the commission subsequently disallows for cost recovery.[115]

[115]The Baseline Capital Projects Credit was initially proposed on page 97 of the HECO Opening Brief and on pages 11-12 of the HECO Memo in Support. On pages 5-6 of the Consumer Advocate Comments, the Consumer Advocate concurred in

Earnings Sharing

Earnings Sharing Revenue Credits will be the amounts to be returned to customers as credits through the RBA Provision, so as to implement the earnings sharing provision percentages and procedures described in the RAM Provision.[116] The HECO Companies and the Consumer Advocate state that the purpose of earnings sharing is to ensure that the total amount of revenues being recovered through base rates, RBA/RAM adjustments and other surcharges does not contribute to excessive earnings by the utility, while retaining some incentive for management to seek cost reductions and productivity gains beyond what are recognized within the RAM formulas.[117]

As part of its annual filing, the HECO Companies will prepare a calculation comparing the achieved return on average common equity for the Evaluation Period for purposes of this earnings sharing mechanism to the following earnings sharing grid, so as to determine any Earnings Sharing Revenue Credit that

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the modification of the Joint FSOP by including the Baseline Capital Projects Credit and urged its inclusion in this Decision and Order.

[116]See Joint FSOP at 18.

[117]The role of earnings sharing as a customer safeguard is further discussed below in Section II.B.6.b of this Decision and Order.

should be recorded against the RBA to effect the prescribed sharing of utility earnings above authorized levels:[118]

Return on Equity ("ROE") at or below the Authorized ROE	Retained entirely by shareholders - no customer credits
First 100 basis points (one percent) over Authorized ROE	25% share credit to customers
Next 200 basis points (one to three percent) over Authorized ROE	50% share credit to customers
ROE exceeding 300 basis points (three percent) over Authorized ROE	90% share credit to customers

The Authorized Return on Equity[119] for this purpose will be the percentage rate of return on equity capital approved by the commission in each respective company's most recently implemented rate case order. The proposed earnings sharing grid is asymmetrical, with no surcharges to customers if achieved ROE is below the authorized level.[120]

Earnings (as measured by ROE) achieved by each of the HECO Companies are to be calculated on a regulatory basis of accounting for each calendar year that includes any RBA surcharge revenue. Ratepayers would then be credited with the revenue equivalent of ROE levels actually achieved within the sharing

[118] See Joint FSOP at 18.

[119] As defined in the RAM Provision and further discussed below, the "Authorized Return on Equity" is the overall weighted percentage rate of return on equity capital approved by the commission in the most recent rate case.

[120] See Joint FSOP at 19.

layers (after removal of any prior period RBA adjustments and routinely disallowed costs).[121]

To determine achieved ROE for purposes of Earnings Sharing Revenue Credits, ratemaking adjustments will be made for recorded types of expenses that are removed in a company's rate filings as well as all commission-ordered expense disallowances. Rate base elements and methodologies are defined by the most recent rate case, but will be updated to reflect current average investment balances for the year. Capital ratios and costs rates will be retained as authorized in either the most recently issued rate case interim or final decision, and synchronized interest will be updated using methods employed in that last rate case for purposes of the earnings sharing mechanism.[122]

Detailed supporting workpapers and electronic files will be submitted coincident with all filings made by the utilities. Any recorded revenues arising from out-of-period adjustments or prior year earnings credits will be identified and removed in preparing earnings sharing calculations. The earnings monitoring and sharing report will be accompanied by detailed supporting workpapers, showing the quantification of achieved earnings and each ratemaking adjustment embedded therein.[123]

Notice of RAM Filing

As described above, notice of the annual Rate

[121] See id.

[122] See id.

[123] See id.

Adjustment Mechanism[124] filing will be provided to all affected customers of the utility by publication in the newspapers of general circulation within 30 days and by including notification with its billing statements within 60 days after the company makes its annual filing pursuant to the RAM Provision. The notice to customers will include the following information:

> (a) A description of the proposed revision of revenues and Earnings Sharing Revenue Credits;
>
> (b) The effect of the proposed RAM Revenue Adjustment on the rates applicable to each customer class and on the typical bill for residential customers; and
>
> (c) The company's address, telephone number and website where information concerning the proposed RAM Revenue Adjustment may be obtained.[125]

b.

Parties' Positions

In their Opening Briefs, the Parties other than the HECO Companies and the Consumer Advocate generally expressed conditional support for the adoption of the RAM component of the Joint FSOP. More specifically, they argued that the RAM adjustment should be linked to performance metrics and service quality goals. The Parties' positions on the RAM are discussed in more detail below.

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[124]The "Rate Adjustment Mechanism" is described in the RBA Provision.

[125]RAM Provision at 9-10.

HECO Companies

The HECO Companies contend that the RAM Provision is an essential element of decoupling, because RBA accounting alone will not provide any opportunity for recovery of inflation-driven cost increases and continuing infrastructure investment between rate cases:

> Costs of utilities generally tend to rise over time, due to a combination of input price inflation and output growth. . . . [U]nder traditional ratemaking, sales increases between rate cases have provided the HECO Companies with opportunities to recover gradual, inflation-driven cost increases between rate cases. However, setting a fixed level of target revenues that do not change between rate cases under sales decoupling provides no ability for the HECO Companies to recover increases in utility costs associated with inflation or new infrastructure investments.[126]

According to the HECO Companies:

> The immediate need for the RAM is driven by the increase in these costs related to the many initiatives in the HCEI Agreement, normal input price and output growth, and to maintaining and improving service reliability with an aging infrastructure while the HECO Companies transition to incorporate more renewable energy resources into their grids and concurrently transform them into smart grids.[127]

The HECO Companies represent that "[r]evenue adjustment mechanisms are almost always included in decoupling true-up

[126]Proposed Final D&O at 51 (citing Joint FSOP at 11).

[127]HECO Opening Brief at 11.

plans,"[128] and state that decoupling also should reduce the frequency of rate cases:

> With decoupling (provided the mechanism includes both a sales decoupling and a compensatory revenue adjustment mechanism), a three-year rate case cycle is expected to be workable. Without decoupling, it has been assumed that a two-year rate case cycle would be required, but it is entirely possible that rate cases would be required in some instances even more frequently.[129]

Consumer Advocate

In its Opening Brief, the Consumer Advocate states that "[t]he RAM provision is needed in addition to the RBA, because the RBA will serve only to hold utility margin revenues constant between rate cases, providing no opportunity for recovery of any increasing costs to provide service."[130] The Consumer Advocate maintains that the RAM provision simplifies the inherently complicated formal rate case process by:

1) Starting with PUC-approved expense levels from the latest rate case decision,

2) Utilizing available recorded plant investment balances and Commission-approved accrual rates in place of forecasts for calculation of depreciation/amortization expenses and to determine the front "half" of the average rate base,

3) Updating only the largest four elements of rate base; Plant-in-Service,

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[128] Id. at 10-11.

[129] Id. at 17.

[130] Consumer Advocate Opening Brief at 17.

Accumulated Depreciation, Accumulated Deferred Income Taxes, and Contributions in Aid of Construction,

4) Utilizing only two expense escalation indices from published third party sources for all labor and non-labor O&M expenses, and

5) Holding the authorized rate of return constant at the Commission-approved level.[131]

The Consumer Advocate also notes that the RAM provision is conservative, in that:

1) Labor expenses that are escalated by the percentage increases documented within each Company's union wage agreements, even if actual non-union wage increases are higher or include incentive compensation pay.

2) Escalated wage expenses are then reduced by an assumed labor productivity offset of 0.76 percent. This productivity offset forces the HECO Companies to find new technologies or business processes that enable it to do more work with fewer employees or reduced overtime hours in order to fully recover its future labor expenses.

3) Non-labor expenses are escalated by the published [GDPPI], which is reflective of national finished goods price trends rather than Hawaii inflation and that captures productivity gains achieved in the broader economy.

4) Only the four largest components of rate base are updated. Changes for Plant-in-Service growth are limited to average historical baseline plant additions (that are both easily verifiable and without escalation of prices) plus major projects that are

[131] Id. at 18.

completed by September 30 (limited to PUC approved total estimated costs).[132]

In addition, the Consumer Advocate states that "[a]voidance of regulatory lag and costs can be expected to improve the financial condition of the HECO Companies, thereby assisting in their ability to perform the many undertakings expected of them within the HCEI Agreement."[133]

DBEDT

While DBEDT, a signatory to the Energy Agreement that includes a RAM component, does not appear to oppose the general RAM concept, DBEDT has not expressly supported the RAM mechanism as specifically agreed upon in the Amended Joint Proposal (i.e., without a performance metric). Rather, DBEDT's statements regarding the RAM have generally been made in connection with recommendations for additional consumer safeguards, clean energy performance metrics, reliability standards and modifications to the ECAC. For example, DBEDT recommends that the commission consider including certain additional "consumer safeguards" in the RAM, such as: (1) imposing caps on total rate increases between rate cases; (2) imposing maximum bounds on cost increases tied to the GDDPI or other cost indices; (3) imposing percentage caps on RAM adjustments for baseline and major capital projects; and (4) excluding or limiting RAM adjustments for certain

[132] Id. at 19-20.

[133] Id. at 21.

specific Major Capital Projects.[134] Moreover, as further discussed in Sections II.B.5 and II.B.6 of this Decision and Order, DBEDT proposes performance metrics and service quality measures, whereby the HECO Companies' recovery of RAM adjustments would be conditioned upon meeting those measures.

In addition to the recommendations above, DBEDT's Opening Brief proposes to exclude all labor cost increases from the O&M expense component of the RAM, arguing that:

> [T]he HECO Companies' O&M labor expense should be maintained at the approved level in the utility's last rate case in the determination of the RAM revenue requirements adjustment. A guaranteed pass-through of labor cost increases at the current contractual wage rate increase as proposed in the HECO/CA Joint Proposal could very likely eliminate the utilities' incentive to prudently manage their labor costs through the contract negotiations with the union. Furthermore, to automatically pass through HECO's current contractual labor wage increase of 4.5% to the ratepayers, especially during these economic times when unemployment is high and increasing, is not prudent, it is unreasonable, and it is not in Hawaii's best interest.[135]

HDA and HREA

HDA's Opening Brief (in which HREA joins) states that "although the proposed RAM may have merit . . . , it has not been clearly established that the RAM is a ***necessary*** measure to provide HECO with just and reasonable rates on an ongoing basis."[136] Nonetheless, HDA acknowledges that the proposed RAM

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[134]See DBEDT Opening Brief at 18-19.

[135]Id. at 30 (emphasis in original).

[136]HDA Opening Brief at 16 (emphasis in original).

could serve to improve "regulatory efficiency" by, among other things, reducing the frequency of rate cases and improving the utilities' financial condition.[137] HDA notes that: (1) "[t]he rate impacts of the RAM would be upward in all cases for all of the utilities under most conceivable circumstances";[138] and (2) implementation of the RAM could reduce incentives for the HECO Companies to control costs unless it is required that they adhere to some minimum period between general rate cases. HDA therefore recommends that any extended approval of the RAM be contingent upon the HECO Companies agreeing to a mandatory three-year rate case cycle in order to maintain some incentives for control of costs.

In addition, HDA makes a number of recommendations in connection with the RAM concerning the continuation of this docket, the review process for the RAM and what safeguards should be considered in connection with the RAM. HDA's positions on those issues are further discussed below in Section II.B.6 of this Decision and Order.

On December 3, 2009, HDA filed a "Memorandum in Response" to the HECO Companies' Interim Motion, in which HDA stated that it "does not oppose nor does it support HECO's Motion," and emphasized that "HDA's position is different than what is proposed in HECO's Motion."[139]

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[137]See id. at 17.

[138]Id. at 18.

[139]Haiku Design and Analysis Memorandum in Response To: Motion for Interim Approval of a Decoupling Mechanism for

Blue Planet and HSEA

Blue Planet's Opening Brief (in which HSEA joins) and Reply Brief state with respect to the RAM that, "In general, Blue Planet supports adoption of the Joint Decoupling Proposal," subject to certain "comments concerning RAM calculation, customer class allocation, and return on equity."[140] Blue Planet's comments included the following: (1) calculation of any inter-rate case revenue enhancement and allocation of any rate increases should reflect, as much as possible, the methodologies used by the commission in a traditional rate cases; (2) service quality standards should be incorporated as part of any RAM to insure that any measures taken by the HECO Companies to reduce O&M expense escalation and capital expenditures would not adversely affect customer service quality and reliability; and (3) the commission should reduce the authorized ROE for the HECO Companies to reflect the transfer of a significant amount of risk from the HECO Companies to their customers.[141]

On December 3, 2009, Blue Planet filed a "Memorandum in Partial Opposition" to the HECO Companies' Interim Motion (in which HREA and HSEA join), wherein Blue Planet states that it

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Hawaiian Electric Company, Inc., Hawaiian Electric Light Company, Inc., and Maui Electric Company, Limited and Memorandum in Support of Motion, filed December 3, 2009 ("HDA Memo in Response") at 3.

[140]Blue Planet Opening Brief at 10; Reply Brief of Blue Planet Foundation, filed on September 29, 2009 ("Blue Planet Reply Brief") at 3.

[141]See Blue Planet Opening Brief at 10-15.

"does not oppose the Motion's request for approval of the HECO RAM in general. Rather, Blue Planet opposes the Motion's request only insofar as it proposes that the Commission make no further decision on the HECO RAM in this proceeding[.]"[142] Blue Planet's comments on the RAM and partial opposition to the HECO Companies' Interim Motion are further discussed below in Section II.B.6 of this Decision and Order.

c.

Findings

The HECO Companies have argued that the RAM is a necessary component to decoupling because, while the RBA will help to stabilize revenues, the RAM will allow the HECO Companies to recover inflationary increases in costs between rate cases. The Consumer Advocate has added that the HECO Companies have agreed to bear a host of new efforts and costs to help achieve energy independence for the State, and that sales growth between rate cases can no longer be used by the HECO Companies to "pay for" these increased costs without needing frequent rate cases.[143] Thus, the proponents of the Amended Joint Proposal assert that the RAM is an essential tool to maintain the HECO Companies'

[142]Memorandum in Partial Opposition to Motion for Interim Approval of a Decoupling Mechanism for Hawaiian Electric Company, Inc., Hawaii Electric Light Company, Inc., and Maui Electric Company, Ltd. Filed November 25, 2009, filed December 3, 2009 ("Blue Planet Memo in Partial Opposition") at 2.

[143]See Consumer Advocate Opening Brief at 8.

financial integrity, while allowing them to achieve the State's energy objectives.

The other Parties to the docket have called for a quid pro quo arrangement, where the HECO Companies can only benefit from RAM adjustments if they achieve performance metrics and meet service quality standards. In addition, as mentioned earlier, the commission is cognizant of the potential for the HECO Companies to lose incentive to control costs when rates will be automatically adjusted via the RAM, rather than through rigorous review in a rate case. Furthermore, the commission is sensitive, particularly when the State is currently in an economic recession, to the fact that the RAM will have an upward effect on rates between rate cases.

Based on the entirety of the record, however, the commission approves the RAM mechanism as proposed in the Amended Joint Proposal, subject to certain modifications and conditions set forth below. In making this determination, the commission specifically focuses on Issue No. III of this proceeding: "[RAM]: How Well Does it Achieve Hawaii's Objectives?" As addressed above, Hawaii's objectives are clearly to wean itself off of fossil fuels. To accomplish this, as noted by the Consumer Advocate, the HECO Companies must undertake substantial new and costly commitments that are aimed primarily at implementing expanded wind and other clean energy technologies and at extensive energy efficiency measures. This is a substantial departure from the HECO Companies' traditional role as energy supplier, where the HECO Companies could rely on

increasing sales volumes to recover costs and earn a fair return on investments. Under these changed circumstances, the commission finds that the traditional regulatory framework will not work effectively to allow the HECO Companies to meet the RPS, as enhanced by Act 155, and other State energy mandates by 2030, and that decoupling, including the RAM, is necessary to align the HECO Companies' financial incentives with the State's energy policy.

As noted by the Parties in the docket, decoupling represents a transformational shift from traditional regulation. To ensure fairness to ratepayers, the commission will consider adjustments to the HECO Commpanies' ROR to account for decoupling in their currently pending rate cases. Moreover, the commission approves the consumer protection features discussed in Section II.B.6 below, including the Earnings Sharing Revenue Credit Mechanism and the Credit Mechanisms for Major and Baseline Capital Projects, which were included in the Amended Joint Proposal. The commission also adds certain modifications and conditions to the RAM, set forth below, to address the concerns that the commission and some of the Parties had with respect to the RAM.

The RAM will put upward pressure on rates. On balance, though, the commission determines that short-term rate impacts will be outweighed by the fact that the RAM should: reduce the frequency of rate cases (the costs of which are borne by ratepayers); improve the HECO Companies' access to capital; and ultimately accelerate Hawaii's transition to a clean and

sustainable energy future -- all of which have long-term benefits to ratepayers. The commission will have the authority to terminate the RAM, if at anytime, the RAM results in unjust and unreasonable impacts on ratepayers.

Regarding performance metrics, the commission declines to adopt them now for the reasons addressed in Section II.B.6, infra. The commission, however, reemphasizes that it is approving decoupling for the specific purpose of incenting the HECO Companies (or removing their disincentive) to accept more renewable energy and energy efficiency measures in accordance with the State's energy objectives. The commission can and will reexamine decoupling if it finds that decoupling is not being used for this purpose.

In response to concerns that the commission and some of the Parties had with the RAM, the following modifications and conditions shall apply to the RAM:

(i) Mandatory Triennial Rate Case Cycle: So that the commission and the Consumer Advocate have a regular opportunity to evaluate decoupling and re-calibrate RAM inputs using commission-approved values, the HECO Companies shall file staggered rate cases every three years, unless otherwise ordered by the commission, commencing as proposed in the Amended Joint Proposal, with HECO's 2011 test year rate case, followed by either MECO's or HELCO's test year rate cases of 2012 and then MECO's or HELCO's test year rate cases of 2013.

(ii) Cost Overruns on Major Capital Projects: As set forth earlier, for purposes of calculating the Rate Base for the

RAM, the costs of Major Capital Projects shall be limited to those amounts most recently approved, e.g., when authorized in the commission's decision approving the HECO Companies' application in compliance with General Order No. 7 or in an interim or final decision and order issued by the commission in the HECO Companies' rate cases. The commission understands this provision to require the HECO Companies to include only commission-approved costs in their estimation of Major Capital Projects that are anticipated to be in service by September 30 of a RAM Period. However, the commission is concerned that the HECO Companies may include actual recorded costs, including cost overruns, for Major Capital Projects in calculating Plant-in-Service for future RAM Periods. The commission accordingly rules that any cost overruns for Major Capital Projects shall not be included in any part of the calculation of the RAM, but may be reviewed in the HECO Companies' rate cases. In the event, though, that actual recorded costs for a Major Capital Project are lower than budgeted costs that were approved for that project in a CIP docket, and the commission has not yet reviewed the project costs in a rate case, the lower recorded costs shall be used for RAM purposes.

(iii) <u>RAM Recovery of CIP CT-1:</u> Consistent with (ii), above, the costs of CIP CT-1 shall be limited to the amount of $163 million that was settled upon, and approved in, HECO's 2009 test year rate case, even though actual recorded costs for the project totaled $193 million. HECO shall not include the $30 million difference between recorded costs and approved cost

for the CIP CT-1 project in the calculation of Plant-in-Service in a future Evaluation Period, unless approved in advance by the commission.

(iv) Disallowance of Merit Wage Increases from the RAM: Allowing an automatic pass through of labor costs through the RAM may be inconsistent with the commission's treatment of wage increases in current rates.[144] For purposes of this initial RAM period, the commission disallows wage increases for Merit employees through the RAM. The commission will allow wage increases for Non-Merit employees to be passed through the RAM, however, the commission cautions the HECO Companies that it will carefully review, and may disallow, any unreasonably high contractual wage increase, particularly if it was bargained for in recessed economic times.

(v) Information Related to Major and Baseline Capital Projects: In their annual tariff filings to be made on March 31st, the HECO Companies shall include, at a minimum, the information, in the same format, pertaining to major and baseline capital projects that is currently included in the HECO Companies' annual reports filed by May 31st of each year, pursuant to Decision and Order No. 21002, filed on May 27, 2004, in Docket No. 03-0257. However, the commission requires the HECO Companies to provide additional information for plant additions with a total cost of less than $1 million. Specifically, the HECO Companies shall

[144]For example, in HECO's 2009 test tear rate case, Docket No. 2008-0083, on an interim basis, the commission denied wage increases for merit employees, but approved wage increases for non-merit employees.

provide this information in a format that is similar to that which is currently used for completed projects with a total cost between $1 million to under $2.5 million.

With these conditions and the other safeguards approved herein, the commission finds that the RAM should contribute to the achievement of Hawaii's energy policy objectives.

4.

Ability of RAM Alternatives to Achieve Hawaii Objectives

The fourth issue in this docket is: "Revenue Per Customer Mechanism and Other Alternatives: How Well Do They Achieve Hawaii's Objectives?"[145]

The alternatives to the RAM that were addressed in this docket are discussed below.

a.

Revenue Per Customer and Other Alternatives

NRRI Scoping Paper

The NRRI Scoping Paper described four basic approaches to decoupling: (1) lost earnings tracker, (2) total sales adjustment, (3) sales-per-customer adjustment, and (4) straight fixed-variable rate design.[146] Of these approaches, attention in this docket was primarily given to the total sales adjustment,

[145]Order Establishing Hearing Procedures at 6.

[146]See Scoping Paper at 10-20.

which was the approach of the parties to the Energy Agreement,[147] and the sales-per-customer adjustment, which is similar to the revenue per customer ("RPC") approach, further discussed below.[148]

HDA's Proposed RPC Mechanism (Sales Revenue-per-Customer Adjustment)

As proposed by HDA, decoupling would be implemented as proposed in the RBA Provision, except that the RPC mechanism would be used to adjust the periodically calculated allowed recovery target instead of the RAM. HDA's RPC recoupling mechanism would allow recovered target revenues to grow in the years between rate cases in proportion with an index of the number of new customers.[149] However, as noted by the HECO Companies, HDA did not take the position that the RPC mechanism

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[147]See Division of Consumer Advocacy's Comments on the National Regulatory Research Institute Paper, filed February 10, 2009, at 2-3.

[148]HDA initially proposed a "fixed charge per customer" earnings decoupling mechanism in its response to NRRI Scoping Paper, Appendix Question 2. HDA withdrew the "fixed charge per customer" earnings decoupling mechanism, stating that this approach is not correct because it is not consistent with the HECO Companies' ECAC reconciliation mechanism, and proposed a "revenue per customer" approach to "recoupling" as an alternative to the HECO Companies' proposed RAM. See Haiku Design and Analysis Final Statement of Position, filed May 11, 2009, at 3, 5. (Blue Planet filed a joinder to HDA's Final Statement of Position on May 11, 2009.) In addition, HREA noted that it was evaluating an alternative decoupling mechanism based on the Idaho Fixed Cost Adjustment Decoupling Mechanism Model ("Idaho Model"), also referred to as a "true-up mechanism" by Idaho Power. HREA subsequently withdrew the Idaho Model from consideration in its Initial Statement of Position. See Hawaii Renewable Energy Alliance Initial Statement of Position, filed March 30, 2009, at 3.

[149]See HDA Opening Brief at 23. A detailed description of the RPC mechanism is provided in Haiku Design and Analysis Response to Information Requests Transmitted by the Commission on June 5, 2009, filed on June 9, 2009.

should be adopted instead of the RAM.[150] As described by HDA's representative in its closing statement, its intent was to offer a "vanilla" alternative to the RAM in the form of an RPC mechanism, which was not intended to address financial integrity issues such as regulatory lag.[151]

During the panel hearing, RPC mechanisms were discussed at length by the Parties. Although not specifically recommended by HDA, the discussion also considered the feasibility of providing a RPC mechanism plus rate cases as an alternative to the Amended Joint Proposal to address: (1) the anticipated revenue shortage due to the HECO Companies' commitments in the Energy Agreement; and (2) keeping the HECO Companies relatively strong financially.[152] HDA stated that regulatory lag would still exist under this option.[153]

b.

Parties' Positions

According to the HECO Companies, the RPC mechanism proposed by HDA does not attempt to address the objectives of the RAM to partially recover, between rate cases, the increases in costs that are fixed in the short term due to inflation, changes in utility output, and investments in utility infrastructure and,

[150] See HECO Reply Brief at 20.

[151] See Tr. Vol. III at 723 (Freedman).

[152] See Tr. Vol. II at 442, 445 (Hempling).

[153] See id. at 446-47 (Freedman).

thus, to help maintain the financial health and integrity of the utility.[154] The HECO Companies posit that:

> RPC mechanisms are commonly employed by natural gas local distribution utilities (LDCs), where a large portion of fixed costs are tied directly to, and vary with the number of customers. The HECO Companies' fixed costs are not related to the number of customers. Thus, as a means to help ensure that the Companies remain financially healthy between rate cases, the RPC methodology will not perform nearly as well as the RAM.
>
> To avoid financial attrition, utilities operating under RPC freezes file rate cases more frequently. This raises regulatory cost and can compromise utility cost performance. A RAM that provides relief for inflation as well as customer and activity growth makes it possible to simultaneously reduce regulatory cost and improve utility performance. That is why most RAMs that have been implemented in the U.S. and other countries over the years have not employed a RPC freeze.[155]

The Consumer Advocate also does not support the RPC, arguing:

> The premise behind RPC is flawed. The revenue requirement of the HECO Companies is driven by many factors, only one of which is the modest direct cost incurred to connect a new customer. HDA has made no showing that RPC can be expected to produce reasonable results when applied to the HECO Companies or that the fundamental cost basis for the method is defensible. In fact, Mr. Freedman admitted in the hearing that, "I think it's true that the RPC methodology does not track fixed costs as well as the RAM mechanism."(Tr.448)[156]

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[154] See HECO Reply Brief at 20.

[155] Id. at 20-21.

[156] Consumer Advocate Opening Brief at 24.

DBEDT points out that although RPC may be an effective mechanism for a utility with an increasing customer base, the RPC method may not provide adequate rate relief where the increases in costs are far greater than the increases in customers, or where the customer base is decreasing.[157]

c.

Findings

With regard to HDA's "fixed charge per customer" earnings decoupling mechanism and HREA's Idaho Model, the commission finds any issues related to these two proposed mechanisms to be moot, as both have been withdrawn by the sponsoring party.

With respect to HDA's RPC proposal, the commission finds that the RPC mechanism, which was not intended to address issues such as regulatory lag, will not perform as well as the RAM in meeting the objective to maintain the HECO Companies' financial integrity. In addition, the commission finds that the RPC method may not provide adequate rate relief where the increases in costs may be far greater than the increases in customers, or where the customer base is decreasing. Although various "packages," including RPC plus rate cases, were discussed at the hearing, it does not appear from the record that any of these options would reduce regulatory lag, maintain the HECO

[157] See DBEDT Opening Brief at 36.

Companies' financial integrity, or support the achievement of Hawaii's objectives as well as the RAM.

Accordingly, the commission finds that the other RAM alternatives considered in this docket would not achieve Hawaii's objectives as well as the RAM, as proposed in the Amended Joint Proposal, and as modified herein.

5.

ECAC Amendment

The fifth issue in this docket is: "Energy Cost Adjustment Clause Amendment: What are Its Advantages and Its Disadvantages, In Terms of Hawaii's Objectives?"[158]

a.

Background

The ECAC employed by the HECO Companies relies upon a partial pass-through formula that holds management responsible for maintaining the thermal efficiency of generating resources through a fixed sales heat rate that is established in rate cases.[159] This process is intended to provide balanced incentives for management to invest in prudent levels of new capital

[158]Order Establishing Hearing Procedures at 6.

[159]See Consumer Advocate Opening Brief at 27.

investment and maintenance of its production facilities or suffer the consequences of failing to do so.[160]

Concerns about the fixed sales heat rate and its function in a decoupling environment were raised by HDA, HREA, and DBEDT and discussed in detail in the April 20, 2009 technical workshop session involving the Parties to this docket. These concerns are in two areas that were explained by HDA in the panel hearings. First, changes in sales and energy production that are intended to be neutralized under decoupling may actually have an income impact due to the fixed sales heat rate in the ECAC. Second, the introduction of added as-available renewable energy, as envisioned under the Energy Agreement, may adversely impact the system sales heat rate with a resulting ECAC financial penalty to the HECO Companies that should not be allowed to discourage the development and interconnection of such resources.[161]

During the same technical workshop, the HECO Companies identified the following reasons for keeping the fixed sales heat rate: (1) the fixed sales heat rate provides an effective incentive for the utilities to maintain their generating units in order to run as efficiently as possible; and (2) the fixed sales heat rate serves as a risk sharing mechanism, such that the utilities are at risk of not recovering all of their fuel

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[160] See id.

[161] See id. at 27-28 (citing Tr. Vol. III at 556-58 (Freedman)).

expenses if they do not properly manage the generating units' operating parameters under their control.

In their Joint FSOP, the HECO Companies and the Consumer Advocate agreed with HDA that the fixed sales heat rate could result in the utilities recovering more or less than their fixed costs under sales decoupling, and that the fixed sales heat rate may incent the utilities to take less renewable energy under certain circumstances.[162]

Thus, the Parties generally agreed with the concerns raised by HDA that the ECAC should be modified, but HECO and the Consumer Advocate disagreed with the other Parties as to how the ECAC should be modified.

b.

ECAC Amendment in the Amended Joint Proposal

In response to HDA's concerns, in Exhibit D of their Joint FSOP, the HECO Companies and the Consumer Advocate submitted their "deadband concept around fixed sales heat rates," which had previously been discussed in the workshops. The deadband concept proposed a deadband width for HECO of ±50 British thermal units ("Btu")/kWh-sales above and below the test year sales heat rate. The HECO sales heat rate deadband was based on an assumption of the possible impact of decoupling to be equivalent to a 5% reduction in sales and assumed that the relationship between the change in sales and the change in

[162] See Joint FSOP, Exhibit D.

efficiency factor is linear.[163] This resulted in a deadband width of ±50 Btu/kWh-sales above and below the test year sales heat rate, which represents less than 1% of the system sales heat rate for HECO.[164] In the June 25, 2009 Exhibits, the HECO Companies and the Consumer Advocate submitted proposed deadbands for MECO and HELCO of: ±100 Btu/kWh-sales for MECO - Maui Division; ±50 Btu/kWh-sales for MECO - Lanai and Molokai Divisions; and ±100 Btu/kWh-sales for HELCO.[165] The HECO Companies claimed that the relatively small deadband for HECO of ±50 Btu/kWh-sales takes into account the size of the HECO system (relative to those of MECO and HELCO), and the size of the independent power producer ("IPP") facilities expected to be added prior to the resetting of HECO's rate case heat rate target in its 2011 test year rate case.[166]

Based on production simulation runs for scenarios where additional increments of renewable energy generation are

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[163]See Joint FSOP, Exhibit D.

[164]See id.

[165]See Attachment 7 to Revised Exhibit C, submitted with the June 25, 2009 Exhibits.

[166]See page 3 of Attachment 7 to Revised Exhibit C, submitted with the June 25, 2009 Exhibits. The proposed deadband for MECO - Maui Division is ±100 Btu/kWh-sales and was based on production simulation runs that indicate that Maui's diesel system heat rate could increase by 61 Btu/kWh-net based on a decrease in sales by 5%, and could decrease by 45 Btu/kWh net based on an increase in sales by 5%. The proposed deadband for HELCO of ±100 Btu/kWh-sales is consistent with the deadband width proposed for MECO - Maui Division. These deadbands were intended to accommodate small IPP additions (such as photovoltaic ("PV") additions sized below the competitive bidding threshold). The proposed deadbands for MECO - Lanai and Molokai Divisions of ±50 Btu/kWh-sales are consistent with the width selected for HECO. See id.

integrated into the grids, the HECO Companies state that they anticipate that changes in any of the utilities' heat rates could exceed the bounds of the deadbands.[167] In recognition of these potential occurrences, the HECO Companies and the Consumer Advocate identified the circumstances (or triggers) under which the redetermination of the sales heat rates would be undertaken in the future, which included size thresholds for (1) non-utility firm or non-utility non-firm renewable resources (such as wind or PV) from which the utility will purchase capacity and/or energy under a power purchase agreement ("PPA") and (2) utility firm and non-firm renewable resources (such as wind or PV). In addition, a redetermination of the HECO Companies' sales heat rates could be triggered by additions, retirements or modifications to their generating systems, or modifications to their generating system operating procedures, that are expected to increase or decrease the target heat rates by more than the deadband amounts.[168]

The process used to reset the fixed sales heat rate factor was identified in Exhibit C, Attachment 7 of the June 25, 2009 Exhibits.

In its Opening Brief, the Consumer Advocate stated that the proposed ECAC sales heat rate deadbands and procedures for sales heat rate re-determination are reasonable solutions that

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[167] See id.

[168] See id. at 4.

address the concerns raised by the Parties.[169] According to the Consumer Advocate, this approach creates an acceptable range for system thermal efficiency performance variations around expected levels, as may be caused by changing sales levels, without completely discarding the incentives for utility management to maintain and operate its generating resources to achieve efficiency.[170]

The HECO Companies and the Consumer Advocate further assert that the proposed amendment to the existing ECAC mechanism, with the addition of a deadband element would serve to: (1) maintain the utilities' incentive to maximize generation efficiency; (2) provide a mechanism which is responsive to the anticipated increasing adoption of more renewable resources onto the utilities' grids; (3) maintain some risk sharing between shareholders and ratepayers; and (4) allow the utilities some flexibility to reset the sales heat rate in accordance with changes to the utilities' grids and the timing and amount of renewable resources added.[171]

According to the HECO Companies and the Consumer Advocate, the ECAC deadband concept was proposed as a means to balance the sometimes competing objectives of promoting efficient operation and the need to integrate additional

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[169] See Consumer Advocate Opening Brief at 29.

[170] See id.

[171] See Proposed Final D&O at 99.

renewable energy.[172] The Consumer Advocate maintains that if the fixed sales heat rate were eliminated, the HECO Companies' management could neglect their production facilities and pass along any resulting deterioration (increase) in the system heat rate to customers in the form of higher ECAC charges.[173] Additionally, the fixed sales heat rate serves as a risk sharing mechanism between the utilities and their ratepayers,[174] in compliance with Act 162.[175]

The Consumer Advocate notes that "heat rate analyses were performed by the HECO Companies and reviewed by the Consumer Advocate, supportive of the implementation of specific BTU per kilowatt-hour deadbands around the fixed heat rate of each utility."[176] According to the Consumer Advocate, "The deadbands are designed to accommodate all reasonably anticipated changes in sales levels that would produce system heat rate impacts, with triggers for redetermination of the heat rate

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[172]See HECO Reply Brief at 56.

[173]See Consumer Advocate Opening Brief at 27.

[174]See id.

[175]See 2006 Haw. Sess. L. On June 2, 2006, the governor of Hawaii signed into law Act 162, which amends HRS § 269-16. Act 162, in part, states that:

> Any automatic fuel rate adjustment clause requested by a public utility in an application filed with the commission shall be designed, as determined in the commission's discretion, to: (1) Fairly share the risk of fuel cost changes between the public utility and its customers[.]

[176]Consumer Advocate Opening Brief at 28.

target and deadband under certain circumstances involving the addition of new resources that require a [PPA]."[177]

c.

HDA's Full Pass Through Proposal

In its Opening Statement of Position in this docket, HDA proposed, among other things, to convert the existing ECAC to a straight full cost pass through for fuel and purchased energy expenses.[178] HDA offered the following arguments in support of its proposal:

> (a) A straight cost pass through would considerably simplify administration of the fuel adjustments and the decoupling mechanisms. First, it is very simple compared to the existing ECAC. Second, it would simplify the administration of a decoupling mechanism. . . .
>
> (b) A straight pass through is consistent with the objectives of the RAM generally: reduction of risk and uncertainty in full recovery of utility expenses.
>
> (c) The existing ECAC incentives to the utility to operate its system efficiently from a thermodynamic standpoint (to minimize system heat rate) provides some convoluted incentives regarding commitment of purchased power generation units versus commitment of company generation units. With substantial amounts of new renewable generation being added to the utility system, a straight fuel cost pass through would "decouple" utility earnings from resource commitment (and curtailment) decisions. The utility

[177] Id. at 28-29.

[178] See Haiku Design and Analysis Opening Statement of Position, dated March 28, 2009 at 6-7, Item (7).

should not be at financial risk based on resource commitment and curtailment decisions that should be made according to policies (maximization of renewable generation) that conflict with the most efficient thermodynamic operation of the utilities' own generation units.

(d) Similarly, the existing ECAC provides an incentive for the utilities to minimize spinning operation reserve capacity and, in effect, penalizes utility earnings for providing additional operation reserve capacity. This is significant because maximizing the incorporation of intermittent renewable resources requires providing increased operating reserve capacity. The utilities should not be financially penalized for providing ample operation reserves in order to accommodate intermittent renewable generation. A straight fuel cost pass through would decouple utility earnings from operation reserve capacity decisions.

(e) Since the HECO Companies currently dispatch generation resources using AGC controls that are based on minimizing economic costs, regulators have a simple verifiable way to determine that resources are being operated economically. The efficiency incentive in the existing ECAC is not necessary to ensure economic dispatch of system resources.[179]

DBEDT also does not support the adoption of a deadband around the fixed efficiency factor, and noted in its Opening Brief that the ECAC calculation provides a disincentive for the utilities to integrate and add renewable power generation, especially variable or intermittent renewable generation, in the system. Such additions would require the utility to run higher

[179] Id. at 7-9 (footnotes omitted). HREA joined HDA's Opening Brief, in which HDA discussed the merits of a full pass through.

amounts of spinning reserve (or regulating reserve), which is more costly since these units must operate at lower output levels where efficiency is lower.[180]

d.

Findings

Based on the record in this docket, the commission concurs with the Parties' concerns regarding the ECAC as identified by HDA. Under decoupling, the fixed sales heat rates in the HECO Companies' current ECACs may have an income impact and under certain circumstances may result in financial penalties to the HECO Companies that could discourage the development and interconnection of renewable resources.

However, implementing reporting and periodic review requirements as proposed by HDA, to see if HECO is operating efficiently under a full cost pass-through ECAC, is not an effective substitute to a modified ECAC that retains the fixed sales heat rate concept. First, HDA's proposed review would occur after revenue has already been collected from ratepayers, and/or curtailments of renewable energy have already been undertaken. Second, it would shift the burden and cost of monitoring and policing primarily to the commission.

Including a fixed sales heat rate in the ECAC has been a long-standing commission practice. Furthermore, with the

[180] See DBEDT Opening Brief at 31-32 (footnote omitted).

enactment of Act 162 in 2006,[181] "Any automatic fuel rate adjustment clause requested by a public utility in an application filed with the commission shall be designed, as determined in the commission's discretion, to: (1) Fairly share the risk of fuel cost changes between the public utility and its customers. . ."[182] Accordingly, the commission is obligated to consider how a change in the fixed sales heat rates would affect how fuel price risk is shared between the utilities and their customers. Thus, the commission will not eliminate the fixed sales heat rates such that there would be a full pass through of fuel expenses to the ratepayer.

However, the commission also acknowledges that the fixed sales heat rate included in the ECAC could result in the HECO Companies recovering more or less than their actual energy costs under sales decoupling, and that the fixed sales heat rate may incent the utilities to take less renewable energy under certain circumstances.

The commission finds that amending the ECAC to include a deadband around fixed sales heat rates, as proposed in the Amended Joint Proposal, will strike a reasonable balance between the sometimes competing objectives of promoting efficient operation and the need to integrate additional renewable energy. Furthermore, under the Amended Joint Proposal, the addition of larger increments of renewable resources will trigger a study and

[181] See 2006 Haw. Sess. L.

[182] HRS § 269-16(g).

production simulation analysis to be filed with the commission, which will allow the commission, Consumer Advocate and other parties the opportunity to review, before the fact, how the affected utility intends to operate its system to accommodate the addition of the larger renewable resource, and provide performance expectations, which may be useful if subsequent events and/or performance differ from expectations, and problems or concerns need to be resolved by the commission.

Therefore, the procedures for changing the target sales heat rates and the implementation of the sales heat rate deadbands, as described in Exhibit C, Attachment 7 to the June 25, 2009 Exhibits are approved, and shall be made effective upon issuance of interim or final decisions and orders in the HECO Companies' pending rate cases.

In terms of Hawaii's objectives, the commission finds that the advantages of the ECAC amendment included in the Amended Joint Proposal outweigh the disadvantages of the amendment. Accordingly, the commission finds the proposed ECAC amendment is reasonable and in the public interest, and should be approved.

6.

Decoupling Review Process and Safeguards

The sixth issue in this docket is: "What Review Process and Safeguards Should the Commission Consider?"[183]

[183]Order Establishing Hearing Procedures at 6.

The record in this proceeding addresses a number of proposals concerning the review process and safeguards for decoupling, as reflected in both the Energy Agreement, as well as in proposals and recommendations independently submitted by various parties to this docket. As discussed in turn below, these proposals include recommendations regarding: (1) HCEI performance metrics and reporting; (2) an Earnings Sharing Revenue Credits mechanism; (3) a mechanism providing for the refund to ratepayers (with interest) of RAM revenues associated with disallowed costs for Major Capital Projects and Baseline Capital Projects; (4) inclusion of service quality metrics in the RAM; and (5) on-going review of decoupling.

a.

HCEI Performance Metrics

A primary point of difference remaining among the Parties in this docket relates to the issue of clean energy-related decoupling performance metrics, which the HECO Companies now generally support.[184] In fact, the support of some of the Parties for the RAM component of decoupling is qualified by their desire to directly link accomplishment of RPS goals or commitments in the Energy Agreement to the HECO Companies' receipt of revenues under the proposed RAM. In effect, these Parties seek to make the availability of any revenue increases resulting from the RAM the quid pro quo for meeting the

[184] See HECO Reply Brief at 79-80.

commitments.[185] These Parties proposed various metrics, described further below, intended to measure the HECO Companies' achievement of the commitments (which have been referred to as "HCEI Performance Metrics"), and proposed reductions in the RAM revenues if the metrics are not achieved.

HCEI Status Report

The HECO Companies initially questioned the efficacy, necessity and benefits of tying cost recovery under the RAM to achievement of the HCEI Performance Metrics originally suggested by other Parties.[186] However, in the April 20, 2009 technical workshop, in response to the concerns of the other Parties, the Consumer Advocate proposed and the HECO Companies agreed to provide a report on the status of HCEI initiatives, such as new Net Energy Metering ("NEM") (megawatt ("MW") and customers), the amount of new renewable energy purchased under the Feed-in Tariff ("FIT") (MW or kWh) when effective and the increase in other renewable/nonfossil-based energy generation (MW or kWh) ("HCEI Status Report"), as part of its testimony and exhibits in the next cycle of rate cases.[187] The HECO Companies asserted that this status report will be timely and relevant in the proceedings wherein the commission will determine whether the decoupling mechanism and its RBA and/or RAM elements should be continued,

[185] See closing statement of HSEA, Tr. Vol. III at 709 (Duda); see also HDA Opening Brief at 19-21.

[186] See HECO Opening Brief at 78-81.

[187] See id. at 81-82.

modified or terminated.[188] The HECO Companies also agreed to include language in the RAM tariff provision memorializing their commitment to provide the HCEI Status Report in the next rate case cycle.[189]

DBEDT's Proposed HCEI Performance Metrics

DBEDT initially proposed performance metrics that envisioned tying decoupling revenue collection to measurement of: (1) new renewable power from NEM customers interconnected to the system during the year; (2) new renewable power purchased through FITs during the year; (3) new renewable power purchased through the PV Host Program during the year; (4) the increase in other renewable power during the year; and (5) the number of new NEM customers interconnected in the system during the year.[190] In its Opening Brief, DBEDT amended its performance metrics to remove metrics based on initiatives pending commission approval and now propose that the target goals include the addition of new MW from NEM, the addition of new renewable power excluding NEM, and the number of new NEM customers interconnected during the year.[191] DBEDT maintains that linking the HECO Companies' proposed RAM mechanism to performance metrics related to Hawaii's energy goals

[188]See id.

[189]See id. at 46.

[190]See DBEDT's Final Statement of Position on a Decoupling Mechansim for HECO/HELCO/MECO, filed on May 12, 2009, at 13.

[191]See DBEDT Opening Brief at 19-20.

it has obligated itself to help achieve, is necessary, prudent, and in the public interest.[192]

In response, the HECO Companies argued that DBEDT's proposed performance measures are beyond HECO's control, including: (1) the number of NEM installations; (2) the load profiles of customers and the energy output profiles of distributed generation ("DG") systems; (3) the state and federal tax incentives, credits and subsidies available to these customers; (4) the amount of rooftop or land space available at each site; (5) the price of PV and other NEM-qualifying generation technologies compared to the retail price of electricity for customers' rate schedules; (5) the ability of IPP developers to either provide an unsolicited PPA proposal or respond to requests for proposals for energy; (6) the willingness and ability of IPP developers to invest in preliminary siting, permitting and engineering to develop sufficiently detailed PPA project proposals; (7) the availability of qualifying tax credits or tax incentives; (8) the ability of IPPs to obtain project financing; and (9) the ability of IPP developers to obtain all necessary permits and approvals for the construction and operation of generating facilities.[193]

Blue Planet's Proposed CEU PIM

In its Opening Brief, Blue Planet (joined by HSEA) proposed a Clean Energy Utilization ("CEU") Performance Incentive

[192]See id. at 19.

[193]See HECO Reply Brief at 82-83.

Metric ("PIM"),[194] which would implement RAM rate adjustments of +/-$7M, +/-$2M and +/-$2M for HECO, HELCO and MECO, respectively, based upon each company's annual change in percentage utilization of clean energy. The CEU PIM target reflects about a 1% annual increase in the CEU ratio. The CEU PIM is proposed as a symmetrical mechanism "to reward excellent improvement and penalize poor performance with respect to achieving Hawaii energy objectives."[195]

Blue Planet maintains that, in addition to being appropriate as a quid pro quo, a PIM may play a valuable role in achieving Hawaii's critical energy objectives because: (1) a PIM will aid the utilities in complying with the Hawaii RPS law; (2) a PIM may more generally aid in rapid adoption of renewable energy and increased energy efficiency; and (3) a PIM can serve as a powerful tool to promote and encourage public awareness and support for the decoupling mechanism, the Hawaii RPS law, and related energy objectives found in the HCEI and Energy Agreement.[196]

In response, the HECO Companies emphasized the penalty framework that is already contained in the RPS Law, as incentive

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[194] See Blue Planet Opening Brief at 22.

[195] Id. at 24.

[196] See id. at 19-20.

to the HECO Companies to comply with the RPS Law.[197] In addition, the HECO Companies maintain that:

> Blue Planet's proposed CEU PIM is based on annual performance relative to the prior year. Because most MWhs of new renewable energy generation are added in blocks (such as when a central-station wind farm or geothermal facility is placed into service) with periods of less and often no increase in between these blocks, the CEU PIM would reward the utility in the first year of operation, but could penalize the utility in the second year of operation. In an informal discussion with Blue Planet, the Companies raised the issue of the "lumpiness" of results as one of the primary concerns with the CEU PIM.[198]

HECO Companies' Proposed IPM

In their Opening Brief, the HECO Companies took the position that tying a "performance-based" indexing of HCEI goals to the RAM is not necessary, because: (1) the RAM will be reviewed in each of the HECO Companies' subsequent rate cases in which decoupling will be implemented; (2) there are mechanisms in the Joint FSOP for the review and discontinuance, if appropriate, of the decoupling mechanism; and (3) the RPS Framework includes de facto enforcement and penalty provisions should the HECO Companies fail to make adequate progress toward the renewable energy goals.[199]

According to the HECO Companies, in addition to falling in line with Hawaii's RPS law and related RPS penalty framework,

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[197]See HECO Companies' Opening Brief at 79.

[198]HECO Reply Brief at 85.

[199]See HECO Opening Brief at 79.

any performance-based indexing of HCEI goals to the RAM "should also take into consideration that adding renewable resources to the system is often 'lumpy', yet takes a considerable amount of effort and time to complete."[200]

Noting that there is very little agreement among the Parties regarding the HCEI Performance Metric issue, HDA proposed that the commission take advantage of immediate opportunities by issuing an interim decision and order in the instant docket approving the RBA and RAM for HECO and continuing the decoupling proceeding to address the HCEI Performance Metric issue along with other decoupling issues.[201]

In general, the HECO Companies stated that they supported HDA's proposal. Accordingly, in their Reply Brief, the HECO Companies indicated that they -

> are willing to continue the dialogue with the other parties regarding the linkage between accomplishment of RPS goals and decoupling as long as both award and penalty provisions are included in the performance incentive mechanism and the performance incentive mechanism is consistent with the RPS law as amended by Act 155 (2009). Therefore, the HECO Companies now generally support the adoption of some type of broad-based clean energy [PIM] in this proceeding, subject to agreement on the specific mechanism and its details.[202]

Subsequently, as a result of "continued discussions with one of the other parties in the docket" and in connection

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[200]HECO Reply Brief at 79.

[201]See HDA Opening Brief 7-8.

[202]HECO Reply Brief at 79-80.

with their Interim Motion, the HECO Companies proposed (1) the continuation of this proceeding for the primary purpose of evaluating the design and potential adoption of clean energy-related decoupling performance metrics, and (2) the adoption of an interim performance metric ("IPM"), which would apply to HECO's 2011 RAM and terminate when the interim decoupling mechanism terminates, which "would give the parties and the Commission an opportunity to evaluate the performance metric or PIM concept."[203] Specifically, the HECO Companies proposed an IPM target of 40 MW of new renewable energy procured between November 30, 2009 and December 31, 2010, through the various procurement methods including PPAs, NEM, Schedule Q, and/or FITs when approved by the commission.[204] The HECO Companies noted, however, that their proposed IPM was only contemplated as a temporary measure if this docket were continued in order to more carefully develop a permanent and balanced performance mechanism.[205]

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[203]HECO Memo in Support at 21-22.

[204]See id. at 22.

[205]See id.

As discussed further below, the Consumer Advocate objected to the implementation of the IPM that HECO proposed as part of its requested interim relief in this docket.[206]

HDA

HDA supported the concept of linking RAM revenue changes to measured achievement of clean energy metrics. HDA's Opening Brief (in which HREA joins) states that:

> If the reasons for allowing revenue enhancements such as the proposed RAM are as compensation for HECO's agreement to the terms of the Energy Agreement, it would be appropriate to make RAM revenues contingent upon HECO's performance in implementing the other terms of the Energy Agreement.[207]

However, HDA notes that "[i]f performance measures are to be implemented in this proceeding they need to be characterized in substantially more detail than what is currently on the record and they need to be appropriately examined." Thus, HDA suggests that "[f]urther examination of appropriate performance measures could be taken up in the continued proceedings" that HDA recommends.[208]

Consumer Advocate

"[T]he Consumer Advocate is not adverse to the concept of performance metrics being incorporated within the regulatory process." "[H]owever, due to the advanced state of the docket, the inability to thoroughly evaluate the proposed threshold and

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[206] See Consumer Advocate Comments at 3, 6-11.

[207] HDA Opening Brief at 20-21.

[208] Id. at 21.

related matters, the Consumer Advocate is concerned with the proposed continuation of the docket and inclusion of the proposed PIM."[209] As a result, in its comments on the HECO Companies' Interim Motion, the Consumer Advocate states that the final order issued in this docket should "reject HECO's invitation to implement a newly-created interim performance incentive mechanism that has not been subjected to critical examination by the Parties or presented in the panel hearings . . . ."[210]

In support of its position on this issue, the Consumer Advocate notes that: "no consensus has emerged on clean energy performance expectations, penalties or incentives" and that "[t]he work done to date illustrates the tremendous uncertainties that continue to surround the complex legal, regulatory and technical processes involved in actually developing and integrating renewable resources."[211]

The Consumer Advocate states that there is "no evidentiary support for the newly proposed [PIM] now being proposed by HECO" and that "HECO's Motion does not explain how the 40MW target was derived or why it is reasonable and does not clearly define whether procurement must be complete with the resource in service and producing power in order to count."[212]

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[209]Consumer Advocate Comments at 10-11.

[210]Id. at 5.

[211]Id. at 6.

[212]Id. at 8.

According to the Consumer Advocate:

> In the event the 40 MW target is overly optimistic and actual achieved results are lower, the RAM revenues intended for 2011 may be arbitrarily reduced to the financial detriment of HECO. On the other hand, if HECO is readily able to equal or exceed this proposed "target" with renewable projects already nearing fruition, no incentive is achieved because RAM revenues cannot exceed 100 percent of the amounts generated by application of RAM formulae. Alternatively, tying realization of RAM revenues to successful procurement of the 40MW target may encourage HECO to expedite contract negotiations on less than optimal terms, to the long term disadvantage of ratepayers.[213]

Thus, "the Consumer Advocate is concerned that the proposed metric would not actually produce the desired results, and may actually produce unreasonable financial results without regard to meaningful clean energy performance measurement."[214]

The Consumer Advocate also notes that "[p]rovisions were made in the [Joint FSOP] to hold the HECO Companies fully accountable for their performance relative to RPS objectives and the other commitments made by the utilities in support of clean energy," and "encourages issuance of a Final Order that adopts the Joint FSOP and the agreement therein for formal review of HECO's achieved HCEI performance as part of the global review of decoupling in the context of HECO's 2011 rate case."[215]

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[213] Id.

[214] Id. at 9.

[215] Id. at 9-10.

The Consumer Advocate further points out that "[t]he potential loss of decoupling benefits by the HECO Companies, should they fail to perform reasonably relative to commitments made in the Agreement, will serve as a strong incentive for such performance."[216]

Findings

The commission finds the Consumer Advocate's arguments with respect to the inclusion of a clean energy performance metric in the HECO Companies' decoupling mechanism to be more persuasive than the arguments raised by the other Parties, and that the record in this docket does not support the inclusion of a fully developed performance metric in the HECO Companies' decoupling mechanism at this time. The commission finds that the Amended Joint Proposal contains provisions for a report on the status of certain HCEI initiatives that will be subject to discovery and analysis by the Consumer Advocate and other parties and will serve to hold the HECO Companies sufficiently accountable for their performance relative to RPS objectives and their other commitments in support of clean energy, at least until decoupling is reviewed in the HECO Companies' next round of rate cases. The commission finds that the potential loss of decoupling benefits by the HECO Companies, should they fail to perform reasonably relative to commitments made in the Energy Agreement, will serve as an incentive for such performance.

[216] Id. at 10.

Accordingly, the commission declines to adopt a clean energy performance metric for the HECO Companies at this time. The commission acknowledges, however, that it is important to have clearly defined objectives and measurements of success. Therefore, in future reviews of the effectiveness of decoupling and its relationship with Hawaii's clean energy initiatives, the performance of the HECO Companies after decoupling is implemented, and the concept of performance metrics should be appropriately investigated to allow the commission to consider the need for such metrics in the future. Moreover, as stated earlier, the commission approves decoupling herein for the specific purpose of incenting the HECO Companies (or removing their disincentive) to accept more renewable energy and energy efficiency measures in accordance with the State's energy objectives. The commission can and will reexamine decoupling and may revoke it if it finds that decoupling is not being used for this purpose.

b.

Earnings Sharing Revenue Credit Mechanism

As noted above, the Amended Joint Proposal includes an Earnings Sharing Revenue Credit mechanism. Specifically, the HECO Companies and the Consumer Advocate propose the following earnings sharing grid to determine any Earnings Sharing Revenue Credit that should be recorded against the RBA to effect the prescribed sharing of utility earnings above authorized levels:

ROE at or below the Authorized ROE	Retained entirely by shareholders - no customer credits
First 100 basis points (one percent) over Authorized ROE	25% share credit to customers
Next 200 basis points (one to three percent) over Authorized ROE	50% share credit to customers
ROE exceeding 300 basis points (three percent) over Authorized ROE	90% share credit to customers

According to the HECO Companies, the earnings sharing mechanism serves to: (1) provide a backdrop for the uncertainty associated with implementation of the Joint FSOP sales decoupling proposal; (2) prevent excessive cumulative cost recoveries (i.e., excessive revenues) under sales decoupling and the various new surcharge mechanisms envisioned by the Energy Agreement; (3) provide a periodic filing under the RAM as an aid to regulatory understanding of whether the RAM is reasonably balancing the interests of the utilities and ratepayers; and (4) explicitly reward utility performance with a sharing of any higher returns on investment if costs are successfully contained below RAM escalation rate expectations.[217]

All of the Parties appear to support the earnings sharing mechanism. As noted by the Consumer Advocate:

> Any excessive earnings that may result from mis-specification of RAM inputs is self correcting in the short run through the earnings reporting and sharing provision which provides the HECO Companies a limited incentive to outperform inflation indices in the short term. Notably, the earnings sharing provision is not symmetrical, so ratepayers will be credited with a share of any

[217] See HECO Opening Brief at 45; HECO Reply Brief at 52.

> above-authorized ROE that is achieved, while the HECO Companies cannot collect any additional revenues if its achieved ROE is less than authorized.[218]

DBEDT lists "the inclusion of an earnings-sharing mechanism in the RAM design" among a list of provisions that DBEDT maintains will "balance the benefits to the utility with consumer protection and benefits . . . ."[219]

"HDA supports the ROE sharing mechanism proposed by the Consumer Advocate and now incorporated in the RAM."[220] HREA joins in HDA's position.[221]

Blue Planet states that "[i]t is appropriate for [ROE] sharing, as proposed in the Joint Decoupling Proposal, to be incorporated into any RAM adopted by the Commission."[222] HSEA joins in Blue Planet's position.[223]

Findings

Based on the record in this docket, in which all Parties are in agreement as to this issue, the commission finds that the Earnings Sharing Revenue Credit mechanism included in the Amended Joint Proposal and reflected in the RAM Provision will allow both the HECO Companies and their customers to benefit from any earnings experienced by the HECO Companies' shareholders

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[218]Consumer Advocate Opening Brief at 33.

[219]DBEDT Opening Brief at 54.

[220]HDA Opening Brief at 23.

[221]See HREA Joinder at 1.

[222]Blue Planet Opening Brief at 11.

[223]See HSEA Joinder at 1.

above the utilities' authorized ROEs. Accordingly, the commission finds that the earnings sharing mechanism will result in just and reasonable rates, and should be implemented.

c.

Credit Mechanism for Major and Baseline Capital Projects

In the Joint FSOP and as described above, the HECO Companies and Consumer Advocate proposed to include major capital projects that are expected to be placed into service in the first nine months of the RAM year. The Amended Joint Proposal includes a refund condition in instances where Major Capital Project cost overruns may be subsequently disallowed when reviewed in a rate case, and the wording in the RAM Provision was revised to incorporate the Major Capital Projects Credits provision.[224] None of the Parties objected to this provision.

In support of this mechanism, the HECO Companies noted in their Opening Brief that:

> As major projects might experience delays in completion due to a variety of reasons, the Major Capital Projects Credit mechanism would refund ratepayers with interest for major capital projects originally included in the rate base RAM calculation but were subsequently placed into service after the first nine months of the RAM year. This provides a safeguard for ratepayers in having to pay for capital projects which have not

[224] See HECO Memo in Support at 11 (citing HECO Opening Brief at 46); see also Consumer Advocate Opening Brief at 31 (citing the July 13, 2009 Responses).

> been placed into service in the first nine months as initially projected in the RAM year.[225]

The RAM Provision also includes expanded rate base RAM language to state that the HECO Companies will refund (with interest) RAM revenues associated with any subsequently disallowed costs for Baseline Capital Projects (i.e., projects estimated to cost less than $2.5 million).[226] With the revision, called the Baseline Capital Projects Credits, if Baseline Capital Project costs are disallowed to a point where the total amount of Baseline Capital Projects' costs are below what was estimated and used to calculate the rate base RAM, the HECO Companies will refund the RAM revenues associated with the difference, with interest.[227] These credit provisions should address any concern that ratepayers might "pay" for projects that have not been reviewed and found to be "prudent".[228]

Also, none of the Parties appear to object to the modification for Baseline Capital Projects included in the HECO Companies' Opening Brief. For example, the Consumer Advocate

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[225]HECO Opening Brief at 46.

[226]See HECO Memo in Support at 12 (citing HECO Opening Brief at 98).

[227]A specific adjustment must also be applied to remove any disallowed plant-in-service and related rate base depreciation and deferred tax balances from the recorded balances used in the Rate Base RAM as of the end of the Evaluation Period. See Proposed Final D&O at 132 n. 267.

[228]HECO Memo in Support at 12 (citing HECO Opening Brief at 97-98).

states that, "We concur in this modification . . . and urge its inclusion in the Commission's Final Order."[229]

Findings

Based on the record in this docket, the commission finds that the capital project credit mechanisms included in the Amended Joint Proposal, as modified herein in Section II.B.3, supra, will help to address any concern that under the proposed decoupling mechanism, ratepayers might be required to pay for the costs of projects that would otherwise be disallowed by the commission. The provisions ensure that any disallowance of excessive project costs or any premature inclusion of major projects in the RAM will be remedied through subsequent refunds with interest. Accordingly, the commission finds that the credit mechanisms for Major Capital Projects and Baseline Capital Projects will result in just and reasonable rates, and should be implemented as reflected herein and in the RAM Provision tariff.

d.

Service Quality Metric

Through IRs and during the panel hearings, questions were raised as to whether, under decoupling, the HECO Companies will have an adequate incentive to maintain their facilities or make repairs in a timely fashion during outages.

[229]Consumer Advocate Reply Brief at 29; see Consumer Advocate Comments at 6.

In their responses to PUC-IR-2[230] and PUC-IR-37,[231] the HECO Companies pointed out that: (1) service quality provisions are not commonly found in revenue decoupling plans; (2) a utility's service quality is most likely to be jeopardized when real profits are to be made by cutting line maintenance expenses and other costs of maintaining or improving quality; (3) four years (as opposed to three years, as set forth in the Amended Joint Proposal) is normally considered the threshold term that would qualify an alternative regulation plan to be classified as an example of performance-based regulation ("PBR"), with cost containment incentives sufficiently strong to warrant quality concerns; (5) where quality provisions are included in PBR plans, they oftentimes involve only the monitoring of quality and not a program of awards and/or penalties, especially in first generation plans;[232] (6) the earnings sharing mechanism included in the Amended Joint Proposal would weaken incentives to take extreme cost containment measures that could jeopardize

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[230]PUC-IR-2 requested that the Parties discuss the service quality standards, such as the one mentioned in RAP's Revenue Decoupling- Standards and Criteria for the Minnesota Public Utilities Commission, dated June 30, 2008, which were intended to overcome an indifference to lost services that sales decoupling may create.

[231]PUC-IR-37 requested that the Parties discuss service quality targets that have been used as part of price or revenue cap regulatory paradigms (e.g., Massachusetts).

[232]See HECO Opening Brief at 83-84; see also HECO Reply Brief at 70-71. Following the hearing, the commission again asked how the HECO Companies will address the issue of outages and the target revenues. The HECO Companies responded in Attachment 8 to their July 13, 2009 Responses.

quality;[233] and (7) any service quality standards would have to be tailored to the circumstances of the utilities affected by the standards, in order to avoid unfair or unintended consequences.[234]

Thus, if service quality standards are introduced, the HECO Companies recommended, in their IR responses, starting with service quality monitoring programs that do not involve awards or penalties.[235] Nevertheless, the HECO Companies proposed individual company service quality benchmarks for SAIDI in their Opening Brief if this alternative is incorporated into the RAM, to address the commission's concerns regarding service reliability if decoupling is implemented.[236]

The Consumer Advocate notes that a problem posed by tying a service quality metric to a RAM is that:

> [U]tility spending on new plant investment or O&M does not fall cleanly into categories such as 'reliability' or 'new customers' or 'Act 155 compliance', requiring largely judgmental filtering and classification of potentially thousands of construction projects and O&M expenditures to comply with any prescribed ratemaking formula using these terms. As a consequence, the NRRI alternatives defining eligible RAM transactions lead to substantially increased

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[233]See HECO Opening Brief at 85; see also HECO Reply Brief at 71.

[234]See HECO Opening Brief at 86. There are other differentiating factors among the service territories, which have been discussed in service reliability investigations. For example, the larger area of HELCO's service territory, and its lower customer density, affect the travel times (and, thus, the service restoration times) for HELCO service crews. See id. at 86 n.86.

[235]See id. at 86.

[236]See id. at 87-89.

> complexity for the HECO Companies to develop and compile information not typically maintained in the normal course of business.[237]

In its Opening Brief, Blue Planet (joined by HSEA) states that "[u]tility service quality standards should be incorporated as part of any RAM to insure that any measures taken by the HECO Companies to reduce O&M expense escalation and capital expenditures would not adversely affect customer service quality and reliability."[238]

DBEDT's Opening Brief similarly states that "it is equally important and necessary for the consumers' benefit to link the allowed RAM amount to certain service reliability standards . . . ."[239]

> DBEDT proposes that for every service interruption lasting longer than the above SAIDI target goals during the year preceding the RAM year, the total target revenue requirements adjustment (excluding O&M labor, fuel and purchased power costs) for the RAM year will be reduced based on the kWh sales that would have been served during the entire outage period. For example, if HECO experienced a service interruption lasting for 120 minutes during the preceding year, the total RAM revenue requirements adjustment will be reduced by an amount equal to the total adjustment expressed on a per kWh basis for the current RAM year (i.e., calculated total RAM adjustment ÷ estimated kWh for the RAM period) multiplied by the estimate of the kWh lost or kWh not served during the entire service interruption period.[240]

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[237]Consumer Advocate Opening Brief at 26.

[238]Blue Planet Opening Brief at 11.

[239]DBEDT Opening Brief at 26-27.

[240]Id. at 28. In response to DBEDT's proposal, the HECO Companies maintain that DBEDT has misinterpreted the SAIDI, and

Among "several safeguards" identified in its recommendations regarding Issue VI in this docket, HDA (joined by HREA) recommends "[c]onsideration of performance incentives to ensure reliable service and diligent implementation of HCEI initiatives",[241] but does not appear to make any specific recommendations with respect to a service reliability metric.

"HREA would agree that some form of a reliability standard would be appropriate . . . . However, HREA does not believe there has been sufficient time in this proceeding to address the issues regarding HECO's specific [SAIDI] proposal." Thus, "[g]iven the development of reliability standards is to be initiated in the FiT docket, HREA recommends that consideration of any utility reliability standard with respect to decoupling be postponed pending the outcome of the directed activity on the FIT docket . . . ."[242]

Findings

Based on the record in this docket, the commission declines to adopt a service quality metric in connection with the decoupling mechanism for the HECO Companies at this time. The commission finds that the record in this proceeding with respect to any service quality metric is not sufficiently developed for

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that the SAIDI is not representative of any single interruption as DBEDT implies in its proposal above. See. HECO Reply Brief at 74.

[241]HDA Opening Brief at 34-35.

[242]Hawaii Renewable Energy Alliance's Post-Hearing Reply Brief, filed September 29, 2009, para. 2.

the commission to make a determination that it would be reasonable to adopt a service quality metric for the HECO Companies. In addition, the commission agrees with HREA that, in light of the FIT investigation that is ongoing in Docket No. 2008-0273, consideration of any utility reliability standard with respect to decoupling should be postponed pending the outcome in the FIT proceeding.

It should be recognized, however, that the issues of service quality and performance metrics are appropriate issues to be examined in the context of utility regulation. As such, if, in the context of other ongoing or future proceedings or in the evaluation of the effectiveness of decoupling in helping to meet Hawaii's objectives of energy independence it becomes evident that the inclusion of some form of performance metrics might be reasonable and appropriate, the commission will investigate and consider the inclusion of such metrics in the future.

e.

On-Going Review of Decoupling

A number of review provisions are included in the Energy Agreement, which provide the commission, the Consumer Advocate and the HECO Companies the ability to review the performance of revenue decoupling and take steps to correct, suspend or terminate the mechanism. These provisions include the following:

> (1) The parties agree that the decoupling mechanism that will be implemented will be subject to review and approval by the commission.

> (2) The commission may review the decoupling mechanism at any time if it determines that the mechanism is not operating in the interests of the ratepayers.
>
> (3) The utility or the Consumer Advocate may also file a request to review the impact of the decoupling mechanism.
>
> (4) The commission may unilaterally discontinue the decoupling mechanism if it finds that the public interest requires such action.[243]

"The Consumer Advocate believes that these filing and review procedures and the provisions for open-ended correction of errors and refunds assure that the revenue adjustments arising from decoupling can be reasonably reviewed and regulated."[244] According to the Consumer Advocate, the consumer safeguards included in the decoupling proposal "are integral parts of the Joint FSOP and provide the Commission with a continuing opportunity to monitor and correct problems with administration of the two decoupling tariffs or any inappropriate recovery of costs through the tariffs."[245]

In accordance with the Consumer Advocate's position and as noted above, the Amended Joint Proposal provides that the review of the continuation of the RBA and RAM provisions will be undertaken in the HECO Companies' second round of rate cases, to occur from 2011 through 2013, i.e., where rate cases are filed for test years that are three years apart. This will result in

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[243] See Energy Agreement at 33.

[244] Consumer Advocate Opening Brief at 32.

[245] Id. at 33.

the filing of one rate case per year after the initial round of decoupling, providing for an annual review of the Amended Joint Proposal's decoupling mechanisms.

Interim Implementation and Continuation of the Proceeding

At various points in this proceeding, certain parties have expressed support of the continuation of this proceeding beyond the initial implementation of decoupling.

For example, HDA (joined by HREA) recommended that this docket remain open to review the RAM's performance and the impacts on decoupling of decisions made in other HCEI-related dockets, and also to consider requiring the submission of a draft master plan by the end of the first quarter of 2010 in order to understand how the various elements of the Energy Agreement and HCEI initiatives will work together.[246]

Blue Planet's Reply Brief recommends that the commission "consider issuing an interim decision and order" regarding the RBA and RAM, but states that "if the Commission chooses to not adopt the recommendations concerning the PIM, Blue Planet does not support or recommend that the Commission issue an interim order regarding the RBA and RAM . . . ."[247]

Although in its Opening Brief, the HECO Companies argued that: (1) the Parties' performance metric-related concerns have been addressed through modifications to the Amended Joint Proposal; and (2) the proper venue to review demand and supply

[246]See HDA Opening Brief at 39-42 and n.36.

[247]Blue Planet Reply Brief at 12.

resource elements in the Energy Agreement is not in this docket, but rather, in connection with Clean Energy Scenario Planning, in the Interim Motion, the HECO Companies requested implementation of decoupling on an interim basis and that this proceeding be continued for the primary purpose of evaluating the design and adoption of clean energy-related decoupling performance metrics.[248]

In response to the HECO Companies' Interim Motion, the Consumer Advocate states that "[t]he Division does not agree with HECO's proposal to continue this Docket so as to hold additional workshops and statements of position by the parties."[249] Rather, the Consumer Advocate states:

> A detailed and complete record now exists and has been briefed in this Docket and the Commission has been fully advised of the advantages and disadvantages of decoupling at the broad policy level, as well as in the fine points of tariff language. The existing record is supportive of the issuance of a Final Order in favor of decoupling, approving the tariffs needed to implement decoupling.
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> * * *
>
> No purpose will be served by adding more workshops and statements of position, as now proposed by HECO, in an apparent search to find consensus regarding performance measures. HECO has made no showing that the cost and burden of continuation of these proceedings will produce either consensus regarding HCEI performance measures or any more reasonable financial outcome than would result from Commission approval of the JFSOP

[248] See Interim Motion at 2-3; HECO Memo in Support at 19-20.

[249] Consumer Advocate Comments at 3 (emphasis in original).

with its next rate case review of HECO performance.[250]

The Consumer Advocate notes that:

The procedural schedule in Docket No. 2008-0274 did not provide for interim implementation of decoupling or for any continuation of these proceedings after the close of hearings. The procedural schedule that was approved has been completed except for the issuance of the Commission's Order.[251]

According to the Consumer Advocate:

HECO's limited control over many of those processes and the existence of [RPS] with penalty provisions supports a conclusion that the most appropriate forum for detailed analysis of RPS performance is within the next HECO rate case, at which time actual facts and performance can be analyzed without speculation regarding what level of performance should be expected.[252]

In addition, the Consumer Advocate states that:

Of course, it is nearly impossible at this time to predict the timing and outcomes for all of the regulatory provisions, technical and siting/interconnection issues and developer financial challenges that will influence the pace of actual renewable energy project completion and "procurement" by HECO. In this vacuum of accurate foresight, any implementation of potentially large RAM financial penalties to HECO if it should fail to achieve 40 MW by December 2010 is highly speculative. If [sic] fact, such penalties may incent HECO toward an unreasonably accommodative posture in negotiation of PPA terms, from which costs may flow through the proposed Purchased Power Adjustment

[250] Id. at 4.

[251] Id. (emphasis in original).

[252] Id. at 6.

> mechanism, to the immediate and long-term advantage of ratepayers.[253]

DBEDT, in its memorandum in support of the Interim Motion, anticipates that the commission's final decision and order in this docket will resolve issues relating to -

> the final form of a decoupling mechanism; the linking of the RAM component to a performance metric; the ECAC-related issues; inclusion of service reliability standards (SAIDI); the determination of the major capital projects to include in the rate base RAM component; the use of the authorized labor O&M costs (unadjusted) in determining the O&M component of RAM; and the review and evaluation process for the decoupling mechanism that may be adopted and approved by the Commission in this docket.[254]

Blue Planet (joined by HREA and HSEA), in its memorandum in partial opposition to the Interim Motion, states that "Blue Planet opposes the Motions' request only insofar as it proposes that the Commission make no further decision on the RAM in this proceeding."[255]

Findings

Based on the record in this docket, the commission finds the Consumer Advocate's arguments with respect to the ongoing review of decoupling to be more persuasive than the arguments raised by the other Parties. The commission finds

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[253] Id. at 9.

[254] The Department of Business, Economic Development, and Tourism's Memorandum in Support of the Motion for Interim Approval of a Decoupling Mechanism for Hawaiian Electric Company, Inc., Hawaii Electric Light Company, Inc., and Maui Electric Company, Limited, filed on December 3, 2009, at 3.

[255] Blue Planet Memo in Partial Opposition at 2.

that it would not be appropriate to issue an interim order in this docket at this time, as a detailed and complete record now exists that is supportive of the issuance of a final decision and order in this proceeding. Also, as stated above, decoupling and its mechanisms are subject to review and continuation in the HECO Companies' next round of rate cases. HECO has already filed its 2011 test year rate case on July 30, 2010. By the time that the rate case application is reviewed, the ratepayers, the HECO Companies and the commission will have gained some working experience with decoupling in its proposed form. Given that further reviews of decoupling will be conducted in the HECO Companies' future rate case dockets, the commission finds that continuing the instant proceeding in parallel with those dockets would result in an inefficient use of commission resources. Accordingly, for the aforementioned reasons, the HECO Companies' Interim Motion is denied, except for those provisions agreed to by the Consumer Advocate and included in the Amended Joint Proposal.

In addition, the commission finds that the provisions for the ongoing review of decoupling that are included in the Amended Joint Proposal (i.e., in the HECO Companies' future rate cases) will provide the commission with an adequate, reasonable and continuing opportunity to monitor and correct problems with administration of the decoupling mechanisms approved in this Decision and Order. The commission agrees with the Consumer Advocate that the HECO Companies' next round of rate cases will present a more appropriate forum than this

docket for further analysis of the HECO Companies' RPS performance. Accordingly, the commission declines to adopt the recommendations for the continuation of these proceedings beyond the commission's initial approval of decoupling in this Decision and Order.

The commission, however, determines that the review provisions in the Energy Agreement, cited above, should be explicitly adopted as a part of the decoupling mechanism approved herein. Thus, the following conditions shall apply to the future review of decoupling:

> (i) The commission may review the decoupling mechanism at any time if it determines that the mechanism is not operating in the interests of the ratepayers.
>
> (ii) The HECO Companies or the Consumer Advocate may also file a request to review the impact of the decoupling mechanism.
>
> (iii) The commission may unilaterally discontinue the decoupling mechanism if it finds that the public interest requires such action.

f.

Outreach

The commission supports transparency of decoupling to ratepayers to ensure fairness to ratepayers and a smooth transition as decoupling is implemented. Specifically, the commission finds that an outreach plan will be critical to the success of understanding, implementing, monitoring, and reviewing decoupling. The commission accordingly directs the HECO Companies and the Consumer Advocate to develop an outreach plan

to include outreach measures, such as: providing informational briefings; training Call Center personnel to respond to billing inquiries; updating the HECO Companies' website with explanations of decoupling, RAM, and the RBA, including FAQs; structuring the billing statements to be easy to understand and transparent; designating contacts at the HECO Companies' and the Consumer Advocate's offices to handle customer inquiries about decoupling; and tracking the disposition of those inquiries and reporting the same to the commission.

The HECO Companies' and the Consumer Advocate's outreach plan shall be filed with the commission within sixty days of the date of this Decision and Order.

III.

ULTIMATE FINDINGS OF FACT AND CONCLUSIONS OF LAW

The commission makes the following findings of fact and conclusions of law.

1. The Amended Joint Proposal for the implementation of decoupling by the HECO Companies, as modified herein, is reasonable.

2. The State's energy objectives and policies, which have become mandated by statute, include a number of provisions promoting energy independence, renewable energy, and energy efficiency. Decoupling will improve the alignment of the HECO Companies' financial incentives with these objectives.

3. Sales decoupling, as implemented by the HECO Companies through the proposed RBA Provision, is reasonable, will contribute to the achievement of Hawaii's objectives and should be implemented.

4. The ratepayer protections approved herein should ensure that the decoupling mechanism operates fairly to the HECO Companies and their ratepayers. In the event any inappropriate recovery of costs results from decoupling, the commission has the authority to unilaterally discontinue the decoupling mechanism.

5. To assist the commission in its own review of the tariff filings and supporting workpapers to be filed by the HECO Companies, the Consumer Advocate shall file a Statement of Position within 30 days after the HECO Companies make their RBA Provision filings, unless otherwise ordered by the commission.

6. Although the RAM will put upward pressure on rates, on balance, the short-term rate impacts will be outweighed by the fact that the RAM should: reduce the frequency of rate cases (the costs of which are borne by ratepayers); improve the HECO Companies' access to capital; and ultimately accelerate Hawaii's transition to a clean and sustainable energy future -- all of which have long-term benefits to ratepayers.

7. The following conditions are reasonable, and shall apply to the RAM:

(i) Mandatory Triennial Rate Case Cycle: So that the commission and the Consumer Advocate have a regular opportunity to evaluate decoupling and re-calibrate RAM inputs using

commission-approved values, the HECO Companies shall file staggered rate cases every three years, unless otherwise ordered by the commission, commencing as proposed in the Amended Joint Proposal, with HECO's 2011 test year rate case, followed by either MECO's or HELCO's test year rate cases of 2012 and then MECO's or HELCO's test year rate cases of 2013.

(ii) Cost Overruns on Major Capital Projects: Any cost overruns for Major Capital Projects shall not be included in any part of the calculation of the RAM, but may be reviewed in the HECO Companies' rate cases. In the event, though, that actual recorded costs for a Major Capital Project are lower than budgeted costs that were approved for that project in a CIP docket, and the commission has not yet reviewed the project costs in a rate case, the lower recorded costs shall be used for RAM purposes.

(iii) RAM Recovery of CIP CT-1: Consistent with (ii), above, the costs of CIP CT-1 shall be limited to the amount of $163 million that was settled upon, and approved in, HECO's 2009 test year rate case, even though actual recorded costs for the project totaled $193 million. HECO shall not include the $30 million difference between recorded costs and approved costs for the CIP CT-1 project in the calculation of Plant-in-Service in a future Evaluation Period, unless approved in advance by the commission.

(iv) Disallowance of Merit Wage Increases from the RAM: Wage increases for merit employees shall not be included in the

RAM. Non-Merit wage increases may be passed through the RAM, upon careful consideration by the commission.

(v) Information Related to Major and Baseline Capital Projects: In their annual tariff filings to be made on March 31st, the HECO Companies shall include, at a minimum, the information, in the same format, pertaining to major and baseline capital projects that is currently included in the HECO Companies' annual reports filed by May 31st of each year, pursuant to Decision and Order No. 21002, filed on May 27, 2004, in Docket No. 03-0257. However, the commission requires the HECO Companies to provide additional information for plant additions with a total cost of less than $1 million. Specifically, the HECO Companies shall provide this information in a format that is similar to that which is currently used for completed projects with a total cost between $1 million to under $2.5 million.

8. With the foregoing conditions and the other safeguards approved herein, the RAM should contribute to the achievement of Hawaii's objectives and should be approved.

9. The RPC mechanism and other RAM alternatives considered in this docket, but not included in the Amended Joint Proposal, would not achieve Hawaii's objectives as well as the RBA and RAM Provisions included in the Amended Joint Proposal.

10. The proposals included in the Amended Joint Proposal concerning the application of deadbands around the HECO Companies' ECAC sales heat rates, and the proposed process for

re-determining the HECO Companies' Target Heat Rates, are reasonable.

11. The record in this docket does not support the inclusion of a clean energy performance metric or a service quality metric in the HECO Companies' decoupling mechanism. However, it is important to have clearly defined objectives and measurements of success. Therefore, in future reviews of the effectiveness of decoupling and its relationship with Hawaii's clean energy initiatives, the performance of the HECO Companies after decoupling is implemented, and the concept of performance metrics should be appropriately investigated to allow the commission to consider the need for such metrics in the future. Moreover, decoupling is approved herein for the specific purpose of incenting the HECO Companies (or removing their disincentive) to accept more renewable energy and energy efficiency measures in accordance with the State's energy objectives. The commission can and will reexamine decoupling and may revoke it if it finds that decoupling is not being used for this purpose.

12. The Earnings Sharing Revenue Credit mechanism included in the Amended Joint Proposal and reflected in the RAM Provision will result in just and reasonable rates, and should be implemented.

13. The credit mechanisms for Major Capital Projects and Baseline Capital Projects that are included in the Amended

Joint Proposal will result in just and reasonable rates, and should be implemented as reflected in the RAM Provision tariff.

14. The provisions for the ongoing review of and safeguards for decoupling that are included in the Amended Joint Proposal are reasonable. However, the following conditions that were agreed upon in the Energy Agreement should be explicitly adopted and shall apply to the future review of decoupling:

> (i) The commission may review the decoupling mechanism at any time if it determines that the mechanism is not operating in the interests of the ratepayers.
>
> (ii) The HECO Companies or the Consumer Advocate may also file a request to review the impact of the decoupling mechanism.
>
> (iii) The commission may unilaterally discontinue the decoupling mechanism if it finds that the public interest requires such action.

15. It would not be appropriate to issue an interim order in this docket at this time, as a detailed and complete record now exists that is supportive of the issuance of a final decision and order in this proceeding.

16. An outreach plan will be critical to the success of understanding, implementing, monitoring, and reviewing decoupling. The HECO Companies and the Consumer Advocate shall accordingly develop an outreach plan to include outreach measures, as suggested herein, within sixty days of the date of this Decision and Order.

IV.

ORDERS

THE COMMISSION ORDERS:

1. The HECO Companies shall implement decoupling, and commence tracking target revenues and recorded adjusted revenues when rates that reflect a reduced ROR due to decoupling are approved by the commission in either an interim or final decision and order in the HECO Companies' pending rate cases.

2. The Consumer Advocate shall file a Statement of Position within 30 days after the HECO Companies make their RBA Provision filings, unless otherwise ordered by the commission.

3. The HECO Companies shall include the commission's explicit authority to suspend the RBA and RAM tariffs in the tariffs.

4. The following modifications and conditions shall apply to the RAM:

(i) Mandatory Triennial Rate Case Cycle: So that the commission and the Consumer Advocate have a regular opportunity to evaluate decoupling and re-calibrate RAM inputs using commission-approved values, the HECO Companies shall file staggered rate cases every three years, unless otherwise ordered by the commission, commencing as proposed in the Amended Joint Proposal, with HECO's 2011 test year rate case, followed by either MECO's or HELCO's test year rate cases of 2012 and then MECO's or HELCO's test year rate cases of 2013.

(ii) Cost Overruns on Major Capital Projects: Any cost overruns for Major Capital Projects shall not be included in any part of the calculation of the RAM, but may be reviewed in the HECO Companies' rate cases. In the event, though, that actual recorded costs for a Major Capital Project are lower than budgeted costs that were approved for that project in a CIP docket, and the commission has not yet reviewed the project costs in a rate case, the lower recorded costs shall be used for RAM purposes.

(iii) RAM Recovery of CIP CT-1: Consistent with (ii), above, the costs of CIP CT-1 shall be limited to the amount of $163 million that was settled upon, and approved in, HECO's 2009 test year rate case, even though actual recorded costs for the project totaled $193 million. HECO shall not include the $30 million difference between recorded costs and approved costs for the CIP CT-1 project in the calculation of Plant in Service in a future Evaluation Period, unless approved in advance by the commission.

(iv) Disallowance of Merit Wage Increases from the RAM: Wage increases for merit employees shall not be included in the RAM. Non-Merit wage increases may be passed through the RAM, upon careful consideration by the commission.

(v) Information Related to Major and Baseline Capital Projects: In their annual tariff filings to be made on March 31st, the HECO Companies shall include, at a minimum, the information, in the same format, pertaining to major and baseline capital projects that is currently included in the HECO Companies' annual

reports filed by May 31st of each year, pursuant to Decision and Order No. 21002, filed on May 27, 2004, in Docket No. 03-0257. However, the commission requires the HECO Companies to provide additional information for plant additions with a total cost of less than $1 million. Specifically, the HECO Companies shall provide this information in a format that is similar to that which is currently used for completed projects with a total cost between $1 million to under $2.5 million.

5. The procedures for changing the target sales heat rates and the implementation of the sales heat rate deadbands, as described in Exhibit C, Attachment 7 to the June 25, 2009 Exhibits are approved, and shall be made effective upon issuance of interim or final decisions and orders in the HECO Companies' pending rate cases.

6. The HECO Companies shall file a reporting of their performance relative to the clean energy goals and objectives set forth in the Energy Agreement as part of the next round of rate case filings, commencing with HECO's recently filed 2011 test year docket, with such reporting to serve, in part, as a basis for review and possible termination, modification or continuation of the decoupling provisions ordered herein.

7. The following review provisions in the Energy Agreement are expressly adopted as a part of the decoupling mechanism approved herein, and shall apply to the future review of decoupling:

(i) The commission may review the decoupling mechanism at any time if it determines that the mechanism is not operating in the interests of the ratepayers.

(ii) The HECO Companies or the Consumer Advocate may also file a request to review the impact of the decoupling mechanism.

(iii) The commission may unilaterally discontinue the decoupling mechanism if it finds that the public interest requires such action.

8. The regulatory relief granted to the HECO Companies in this Decision and Order may impact the business risks faced by the HECO Companies. Consideration of this impact will be addressed in the HECO Companies' currently pending rate cases, where utility authorized rates of return will be determined.

9. The HECO Companies' Interim Motion is denied as moot.

DONE at Honolulu, Hawaii AUG 3 1 2010.

PUBLIC UTILITIES COMMISSION
OF THE STATE OF HAWAII

By _____
Carlito P. Caliboso, Chairman

By _____
John E. Cole, Commissioner

APPROVED AS TO FORM:

_____
Kaiulani Kidani Shinsato
Commission Counsel

2008-0274.ps

BEFORE THE PUBLIC UTILITIES COMMISSION

OF THE STATE OF HAWAII

----- In the Matter of -----)) PUBLIC UTILITIES COMMISSION)) Instituting a Proceeding to) Investigate Implementing a) Decoupling Mechanism for) Hawaiian Electric Company,) Inc., Hawaii Electric Light) Company, Inc. and Maui) Electric Company, Limited))	Docket No. 2008-0274

DISSENTING OPINION OF LESLIE H. KONDO, COMMISSIONER

I respectfully dissent. In sum, I do not agree with the majority's decision to approve a revenue decoupling[1] mechanism and a Revenue Adjustment Mechanism ("RAM") for Hawaiian Electric Company, Inc. ("HECO"), Maui Electric Company, Limited ("MECO") and Hawaii Electric Light Company, Inc. ("HELCO") (collectively "HECO Companies"). I do not believe that the majority fully understands how the mechanisms will work and, because of that, is adopting the HECO Companies' proposed mechanism that has no performance metrics, limited commission oversight over the annual revenue increases, and inadequate customer protections.

I disagree that it is reasonable or in the public interest to shift essentially all of the HECO Companies' business and economic risks to their customers. That transformational

[1]The majority refers to "sales decoupling." I believe that the mechanism being approved is more commonly referred to as "revenue decoupling."

change to the current regulatory framework will guarantee the HECO Companies increased revenues and profits, will guarantee higher customer bills, and will essentially make the HECO Companies recession-proof. In short, the HECO Companies will get additional money from customers, with no obligation to perform differently than the status quo.

Based upon the record, in my opinion, for the reasons stated below, neither revenue decoupling nor the RAM is in the public interest.

REVENUE DECOUPLING

Stated simply, decoupling is a rate adjustment mechanism that breaks the link between the volume of electric sales and a utility's revenues. Under the commission's current regulatory framework, HECO charges a certain price for each unit of electricity it sells.[2] If a customer uses less electricity, that customer pays less, and if the total volume of electric sales declines, the utility earns less revenue.

With decoupling, however, HECO will earn the same amount of revenue by selling one unit of electricity as it will earn by selling ten thousand units. As electric sales decline -- whether that decline is caused by the down economy, customers' energy efficiency efforts, cooler than normal weather or a system power outage -- customers will pay more for each unit of energy they use to make up for any shortfall in HECO's authorized

[2]For illustrative purposes, I refer specifically to HECO in many parts of this opinion. Generally, the point would apply equally to both MECO and HELCO.

revenue requirement. In short, decoupling insulates HECO from all economic and business risks by guaranteeing HECO's revenues, and shifts those risks to HECO's customers.

A. STATE ENERGY OBJECTIVES ARE NOT SYNONOMOUS WITH THE PUBLIC INTEREST

The majority finds that decoupling is in the public interest, persuaded by the HECO Companies' persistent theme that, without decoupling, they may not be able to undertake the infrastructure and other investments necessary to support the Hawaii Clean Energy Initiative ("HCEI").[3] The mere reference to "HCEI" triggers from the majority the same type of response as Pavlov's dogs to the bell. However, simply because decoupling is included in the Energy Agreement does not allow the majority to ignore their obligation to fully understand the mechanism proposed by the HECO Companies or to independently determine that such a transformational change to the traditional regulatory framework is in the public interest.

The majority frames the threshold issue as whether decoupling will help achieve the state's energy objectives, quoting from the Energy Agreement and citing the legislative mandates establishing the Renewable Portfolio Standards ("RPS") and Energy Efficiency Portfolio Standards ("EEPS"), and summarily

[3]The majority also states that decoupling will result in less frequent rate cases. See Final Decision and Order ("D&O") at 43. That statement, however, is unsupported by the record. Decoupling guarantees recovery of the utility's revenue requirement but it does not provide for growth in earnings. The RAM, which adjusts the utility's revenue requirement to account for inflationary increases in costs and rate base additions, is intended to take the place of a rate case.

concludes that "decoupling will improve the alignment of the HECO Companies' financial incentives with Hawaii's objectives to increase utilization of renewable resources, reduce consumption of fossil fuel, and promote efficient use of energy."[4]

First, in my view, the issue is whether decoupling is in the public interest, not whether decoupling promotes the state's energy policy. The two issues are not the same.[5] The Energy Agreement, while providing important policy direction and memorializing the utilities' commitments, is not state law, and the majority cannot simply assume that the policies reflected in the Energy Agreement are in the public interest.

Second, the relationship between decoupling and more renewable energy is, at best, tangential. Contrary to the majority's apparent expectation, without performance measures or other metrics tied to renewable energy penetration, a decoupling mechanism does nothing to encourage more renewable energy development; the HECO Companies simply will get additional money from customers, with no obligation to perform differently than the status quo. Conversely, the HECO Companies do not require decoupling to integrate more renewable energy.

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[4]D&O at 29-30.

[5]For example, transmitting large amounts of wind energy from Lanai and Molokai to Oahu may be consistent with the state's policy to increase the amount of renewable energy. But, the commission must consider the cost of such energy, reasonable alternatives and the costs of those alternatives, and customer benefits, among other issues, before deciding that the project and associated costs are reasonable and in the public interest. Absent such a determination, notwithstanding the fact that the project may advance the state's energy policy, HECO may not be able to recover the project costs from ratepayers.

In fact, the HECO Companies conclusively rebutted the majority's conclusion that decoupling supports HCEI and the state's clean energy goals when they announced that the MECO and HELCO systems currently cannot accommodate any new variable renewable energy.[6] Implementing decoupling for MECO and HELCO will not magically resolve the issues that are causing and will continue to cause those utilities to reject efforts to interconnect additional variable generation.[7]

Third, the majority claims that decoupling will "improve the alignment" of the HECO Companies' earnings and the clean energy objectives, by removing the incentive to increase earnings by increasing electric sales volumes and the disincentive to support energy efficiency.[8] To address what the majority perceives as an obstacle to achieving the state's clean energy goals, i.e., to remove the disincentive to utility support of

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[6]See Letter from HECO to the commission filed February 8, 2010 in Docket No. 2008-0273; see also Letter from HECO to commission filed February 9, 2010 in Docket No. 2008-0273.

[7]If, as many have suggested, decoupling is the "quid pro quo" for the utilities' commitments to integrate more renewable energy, given the stated inability of the MECO and HELCO systems to presently fulfill their commitments, decoupling is not reasonable or in the public interest for those utilities.

[8]In 2009, the commission transitioned the energy efficiency programs from the HECO Companies to a third-party administrator, Hawaii Energy. In my view, it is therefore unnecessary to address any "disincentive" that the HECO Companies may have to promote energy efficiencies: energy efficiency simply is not part of their current business.

energy efficiency,[9] the majority is implementing a decoupling mechanism that will, essentially, make the HECO Companies recession-proof. If the majority is truly attempting to address the "financial penalty" caused by energy efficiency, it is not in the public interest to address that concern with such an imprecise and unfocused mechanism that likely will cause hardship to many customers.

Lastly, conspicuously missing from the majority's "analysis" is a consideration of the impact that decoupling will have on customers.[10] Ihe customer impact cannot be ignored or summarily discounted, especially given that decoupling shifts

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[9]Throughout the decision, the majority asserts that decoupling will "encourage" the HECO Companies' support for energy efficiency. See, e.g., D&O at 43 (emphasis added). Contrary to the majority's representation, decoupling does not create an economic incentive promoting greater energy efficiency. At best, decoupling establishes utility indifference to energy efficiency and conservation objectives.

[10]The Consumer Advocate deserves equal criticism for accepting decoupling simply because it is in the Energy Agreement. In my view, to protect the public interest that the Consumer Advocate is statutorily mandated to protect, the Consumer Advocate was obligated to make an independent determination as to whether decoupling is reasonable, which it apparently did not do. See, e.g., Transcript of Panel Hearing, filed July 27, 2009 ("Tr.") at 93 ("And I think that only because of the commitments made in the energy agreement is it reasonable to consider decoupling for the HECo. companies."); Tr. at 97 ("If you back out the fact that the CA has made certain commitments in the energy agreement, would your opinion change as to whether or not this decoupling mechanism is reasonable, prudent, etc. . . . I'm not sure. I approached it from the perspective of this is the agreement . . . .); Tr. at 101-102 ("Is it premature for the Commission to implement decoupling now without first having adopted or approved some of these other mechanisms that are in the [Energy Agreement] . . . . Again, our approach and instruction was to honor the agreement as it was structured, which envisioned implementation of decoupling at this time.")

most, if not all, of the utility's business and economic risks to customers.

Clearly, as a result of the majority's decision, customer bills will go up. Using 2009 as an example, HECO's actual revenues were approximately $52 million less than its approved revenue requirement.[11] With decoupling, HECO will recover that revenue shortfall from customers through higher electric rates, which includes additional earnings, i.e., profits, for HECO's shareholders of almost $30 million, less taxes.

It appears likely that low income, fixed income and elderly customers will feel the greatest impact from decoupling and that those customers have the least ability to reduce their electricity use.[12] Those customers simply cannot afford to, for instance, replace their refrigerators with more energy efficient models or to install solar water heaters.

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[11]In HECO's 2009 test year rate case, the commission's interim Decision and Order approved a revenue requirement of $1,371,209,000, a net operating income of $105,702,000, and a rate of return of 8.45%. For 2009, HECO reported an actual return of 6.12%. Assuming HECO's total expenses were approximately the same, excluding taxes, as in the test year, HECO's actual revenues were approximately $52 million less than its approved revenue requirement.

[12]The change from establishing separate residential and commercial Revenue Balancing Accounts, as initially proposed, to a single Revenue Balancing Account, for the sake of administrative convenience, will likely result in greater increases to residential customers' bills. Generally, commercial customers are most impacted by the economy, resulting in greater electric sales declines than experienced by the residential class. With decoupling, in the form approved by the majority, residential customers will cover shortfalls in the HECO Companies' revenue requirement, even shortfalls caused by losses of commercial sales.

To approve such a transformational shift in regulatory policy on the present record, without carefully considering the impact on customers caused by the higher rates, frankly, is irresponsible.[13]

B. THE RECORD SIMPLY DOES NOT SUPPORT THE NEED FOR THE TRANSFORMATIONAL SHIFT IN BUSINESS AND ECONOMIC RISK FROM THE HECO COMPANIES TO THE CUSTOMERS

The HECO Companies represent that, unless they are able to improve their position vis-a-vie the credit market, they may not have access to necessary capital and it may cost more for that capital. They also assert that renewable energy developers may not be able to secure financing without a credit worthy off-taker of the energy.

The record, however, suggests that the HECO Companies' stated concerns about their ability to aggressively integrate more renewable energy without revenue decoupling are purely speculative and overblown:

- The record does not reflect that HECO, MECO[14] or HELCO presently has issues accessing the credit markets, notwithstanding their current credit rating;
- According to Tayne S.Y. Sekimura, the HECO Companies' Senior Vice President and Chief Financial Officer, the additional cost of capital for a company with a credit

[13]Commission rules require the HECO Companies, among others, to report to the commission prior to terminating service to an elderly or handicapped customer. The HECO Companies literally submit hundreds of such reports each year. The number of reports only will increase with the higher electric bills produced by decoupling.

[14]MECO projects an increase in electric sales and utility earnings. Accordingly, the majority's stated reasons for concluding that decoupling for the HECO Companies is in the public interest are inapplicable as to MECO.

rating of "BBB" versus "BBB-" is .25% to .30%, truly insignificant;[15] and

- The HECO, MECO and HELCO systems are currently unable to interconnect all of the projects wanting to supply renewable energy, suggesting that developers are able to secure financing, notwithstanding the HECO Companies' current credit rating.

The economic downturn has caused businesses to take extraordinary measures to address reduced earnings; however, the record is silent as to any meaningful measures that the HECO Companies have pursued or are pursuing to improve their earnings.[16] In my view, before the commission approves a financial "bailout" in the form of decoupling, the HECO Companies first must demonstrate meaningful efforts and initiatives

[15]Tr. at 224-225 ("Just as a means of comparison, when we take a look at a company that is triple B minus rated company, for example, to go out into the market to raise debt and let's say, for this example, we had to raise a hundred million dollars of capital, the difference between a triple B rated company and a triple B minus rated company could mean about 250,000 to $300,000 annually of interest expense, more expense.")

[16]In its 2009 test year rate case, HECO argued <u>against</u> the commission's interim decision to freeze management salaries, defended the electricity discount enjoyed by its employees and retirees, and sought a return of between 10.75% and 11.00% for its investors, even though most of its business and economic risks will be shifted to customers with revenue decoupling. HECO's plan to manage expenses in the current down economy is to stop painting its vehicles blue and yellow, temporarily restrict mainland trainings for employees, and where possible, delay non-critical maintenance. Those cost-saving concessions seem to be an inadequate response, especially when contrasted against the actions of other entities, including the state and the county governments.

undertaken to improve their earnings.[17] In other words, the HECO Companies, just like every other business, must tighten their own belts, uncomfortable as it may be, and reduce costs.

Unfortunately, with their revenue requirement guaranteed under decoupling, and increasing annually, the HECO Companies have little incentive to cut expenses and to find ways to increase their earnings. Instead, the majority is telling customers to pay more so that the HECO Companies can enjoy higher earnings and greater return for their shareholders. I simply don't find that course of action to be justified by the record, especially in the context of the current down economy. The purpose of regulation is not to insulate a regulated company from risks that every business, regulated or otherwise, must address. Unless the HECO Companies show that non-traditional regulation is necessary to address some extraordinary needs, which they have not done in the present record, decoupling is not in the public interest, and I would deny the HECO Companies' request to change the traditional regulatory framework.

REVENUE ADJUSTMENT MECHANISM

Decoupling and the RAM are two completely separate mechanisms, intended to address very different issues. As

[17]For instance, the cost of HECO's defined employee retirement plan is over $20 million per year, which HECO might be able to significantly reduce by transitioning to a 401(k)-type of plan for new employees, under which the company could match employee contributions in years in which it had sufficient earnings. Similarly, in its 2011 rate case, HECO includes over $4 million to pay for the increased cost of employee medical insurance. HECO could consider requiring employees to pay for any increases in future medical insurance costs, as other businesses have done.

described above, decoupling is intended to provide the utility with revenue stability by breaking the link between the volume of a utility's electric sales and its revenues; in contrast, the RAM allows the HECO Companies to increase their authorized revenue requirements to reflect inflationary increases in certain costs and increases to the utility's rate base, without the need to file a traditional rate case.

Unlike the majority, I am not persuaded that the traditional regulatory model, which provides a strong, positive incentive for management to effectively control operational expenses and other costs in order to maximize earnings, is broken. The increases in O&M costs cited by the HECO Companies to support the need for the RAM are not new business risks, but rather typical of any operating business. In my view, management is highly compensated to find efficiencies and other savings to cover any inflationary increases in labor and non-labor expenses, without the need to seek rate relief from the commission.

With respect to rate base additions, I similarly find that the record does not adequately reflect the need for such annual increases. Although the HECO Companies assert that the RAM is needed to finance capital projects and other plant improvements, to me, there are regulatory vehicles available to the utilities to recovery extraordinary capital costs. For instance, the Renewable Energy Infrastructure Program allows the HECO Companies immediate surcharge recovery of capital costs incurred to accommodate renewable energy.

In addition to my general objections to the RAM, as expressed above, I find extremely troubling the manner in which the amounts for the Baseline Capital Projects and the Major Capital Projects are calculated. By allowing the HECO Companies to look forward, the HECO Companies will recover costs from customers that the utilities have not yet even incurred. Traditionally, a utility is not entitled to cost recovery until the capital project is "used or useful" for utility purposes. That concept is well-settled. The RAM, however, increases the utility's revenue requirement on June 1 of each year by adding, among other things, an amount equal to the 5-year average of the actual costs of projects whose costs are less than $2.5 million,[18] even where the capital project is not "used and useful" until December 31 or the costs are not incurred by the utility until December 31. Stated differently, the utility will recover costs that have yet to be expended and may not be expended until December 31, 7 months later.

I find it unconscionable, especially given the current economic conditions and knowing that decoupling will already increase customer bills, that the majority would allow the HECO Companies to use customer funds, interest-free, for up to 7 months. And, if the actual expenditures are less than the 5-year average, HECO will not be required to return

[18]HECO estimates the 5-year average of the baseline capital costs to be over $111 million.

the customers' money for an additional 6 months, i.e., until June 1 of the following year.[19]

The Consumer Advocate supports the decoupling proposal and the RAM primarily because the mechanisms will extend, by one year, the period between HECO's rate cases.[20] Yet, that fact alone does not compel the conclusion that the RAM is in the public interest. Although extending the period between rate cases, even if only by one year, will reduce costs and the administrative burden associated with a rate case proceeding, there are undoubtedly other "costs" that must be balanced.

The majority's decision contains very little information about the form of the required tariff filings and, except for acknowledging that the review will be less than rigorous, includes no description about the manner in which those filings are to be reviewed by the Consumer Advocate and commission staff. The commission has yet to establish any internal process for reviewing those filings. As it currently stands, the majority seems to be giving the HECO Companies a "blank check" to increase rates through decoupling and the RAM, with minimal planned review or oversight.

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[19]For customers who cease electric service before the capital project becomes "used or useful," they will have never received any value for the cost "advance," and the utility is not required to refund such customer once that person or entity is no longer a customer.

[20]Tr. at 100 ("Is that really the key for you, the frequency of the rate cases, then? . . . . That's one of the key (sic). . . . Is that a primary driver? . . . . Yes, I would agree that it is a primary driver.")

In conclusion, based on the current record, I do not believe that decoupling or the RAM is in the public interest. I emphasize that my objection to decoupling and the RAM is not a rejection of the state's efforts to increase renewable energy, to encourage energy efficiency, and to reduce the state's dependence on imported fossil fuel for electricity generation. I remain steadfast in my support of the planned and vetted efforts by the HECO Companies to integrate more renewable energy into their systems.

Rather, in this case, the record is inadequate to support such a transformational change in the current regulatory framework, a change that will raise rates at a time when the customers are less able to pay higher electric bills. How customers will actually benefit from decoupling is speculative; however, the benefits to the utilities are both known and substantial. Until the HECO Companies can provide concrete information, describing the "costs" and "benefits" to both the utilities and its customers, I do not believe that one can reasonably conclude that the mechanisms are in the public interest.

DONE at Honolulu, Hawaii AUG 3 1 2010.

PUBLIC UTILITIES COMMISSION
OF THE STATE OF HAWAII

By
Leslie H. Kondo, Commissioner

CERTIFICATE OF SERVICE

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

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