

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF HAWAII

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

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 decoupling¹ 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

¹The 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

²For 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

³The 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.

⁴D&O at 29-30.

⁵For 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

⁶See 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.

⁷If, 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.

⁸In 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 The customer impact cannot be ignored or summarily discounted, especially given that decoupling shifts

⁹Throughout 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.

¹⁰The 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.

¹¹In 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.

¹²The 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, MECO¹⁴ 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

¹³Commission 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.

¹⁴MECO 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

¹⁵Tr. 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.")

¹⁶In its 2009 test year rate case, HECO argued against 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

¹⁷For 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

¹⁸HECO 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.

¹⁹For 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.

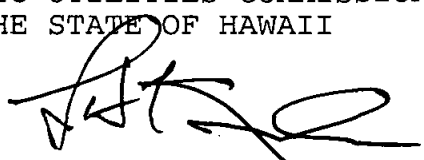
²⁰Tr. at 100 ("Is that really the key for you, the frequency of the rate cases, then? That's one of the key (sic). . . . Is that a primary driver? Yes, I would agree that it is a primary driver.")

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 31 2010 .

PUBLIC UTILITIES COMMISSION
OF THE STATE OF HAWAII

By 

Leslie H. Kondo, Commissioner