

BEFORE THE PUBLIC UTILITIES COMMISSION

OF THE STATE OF HAWAII

----In the Matter of----)
)
PUBLIC UTILITIES COMMISSION)
)
Instituting an Investigation to)
Reexamine the Existing Decoupling)
Mechanisms for Hawaiian Electric)
Company, Inc., Hawaii Electric)
Light Company, Inc., and Maui)
Electric Company, Limited.)
)

DOCKET NO. 2013-0141

ORDER NO. 32735

MODIFYING DECOUPLING MECHANISMS
AND ESTABLISHING BRIEFING SCHEDULE

PUBLIC UTILITIES
COMMISSION

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APPENDIX A

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MODIFYING DECOUPLING MECHANISMS
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In this Decision and Order ("Order"), the Commission orders the HECO Companies¹ to make certain modifications to their decoupling mechanisms, and to apply these modifications to their decoupling filings due to be filed on March 31, 2015. In addition, the commission is establishing a briefing schedule with respect to certain issues, as detailed herein.

¹The "HECO Companies" are Hawaiian Electric Company, Inc. ("HECO"), Hawaii Electric Light Company, Inc. ("HELCO"), and Maui Electric Company, Limited ("MECO").

I.

Introduction

In this Order, the commission is directing the HECO Companies to make certain changes to their existing decoupling mechanisms. The details of these changes are discussed in later sections of this Order. However, in this introductory section, the commission is providing an overview of both the changes and the reasons for those changes. While perhaps overly simplistic, the commission's objective here is to summarize this detailed Order in a manner that is straightforward and easily understandable.

As detailed herein, decoupling mechanisms separate a utility's revenues from its sales. Thus, when sales decline due to energy efficiency measures or customer installations of solar and other types of renewable energy, the utility's revenues are protected. In theory, this means that the utility should be indifferent to energy efficiency programs or interconnection of customer-sited renewable energy projects as its revenues will not decline even though its sales might decline as a result of those projects.

A decoupling mechanism must be carefully balanced so as to achieve the goal of encouraging - or, at the least, not discouraging - the integration of efficiency and renewables by a utility while, at the same time, avoiding a situation whereby utility costs are simply passed through to customers without

appropriate regulatory scrutiny. It is this latter element of decoupling that has concerned the commission with respect to the HECO Companies, as expressed in a number of orders discussed in more detail below.

More specifically, as the HECO Companies' decoupling mechanisms have operated over the past few years, the commission has observed that ever-increasing amounts of so-called baseline capital projects have been flowed through the decoupling mechanism. These projects are associated with the maintenance and operation of the grid and, where the project costs are less than or equal to \$2.5 million, the costs - for all projects in a given annual period - are automatically passed through the Revenue Adjustment Mechanism ("RAM") without prior commission review.

To be sure, these costs may later be reviewed by the commission in a rate case that occurs one or more years after they are recovered from ratepayers. However, given the rapid increase in the overall level of these costs - the baseline project costs have doubled since the inception of the RAM, and are projected to triple or quadruple in the near future² - it is clear to the

²According to the Companies' 2014 decoupling submittals, for 2013, HECO's baseline expenditures increased from \$94 million in 2009 to \$254 million, MECO's baseline expenditures increased from \$33 million in 2009 to \$55 million, and HELCO's baseline expenditures increased from \$34 million in 2009 to \$59 million.

commission that the RAM mechanism must be modified to provide sufficient timely regulatory review and appropriate incentives to the HECO Companies to contain these costs consistent with safe and reliable utility service. Stated differently, the commission concludes that the current RAM mechanism requires a "tune up" to provide proper incentives to encourage the HECO Companies to prudently manage these costs.

The RAM was not originally intended, nor is it reasonable to continue to function, as a mechanism by which the HECO Companies' unprecedented anticipated levels capital expenditures are allowed to enter utility rate base without effective, timely regulatory review. Without approved integrated resource plans, Power Supply Improvement Plans ("PSIPs"), or any other clear, well-vetted strategic plans, and without timely rate cases to provide normal opportunities for periodic review, the Commission has scant assurance that the extensive planned capital expenditures over multiple years are prudent and affordable. The RAM was certainly not intended to serve as a means to circumvent appropriate and timely regulatory review of sizeable utility expenditures or as a substitute for comprehensive resource plans.

On February 7, 2014, the commission issued "Decision And Order No. 31908" ("Order No. 31908"), in which it directed the HECO Companies to implement a reduction in

revenue increases to the RAM, by which the RAM would include the entire effective Rate Base RAM Adjustment from the prior year, but only ninety percent of the amount that the current RAM Period Rate Base RAM Adjustment exceeds the Rate Base RAM Adjustment from the prior year (the "90% adjustment").³ However, the commission noted that it would further address this issue in these "Schedule B" proceedings.

Having reviewed the extensive record compiled with respect to the Schedule B issues, the commission concludes that further changes to the RAM are required and that these changes shall be applied to the decoupling filings due to be filed on March 31, 2015:

1. The Revenue Balancing Account ("RBA") shall be retained. The RBA is the sales decoupling component, which is designed to break the link between the HECO Companies' sales and their total electric revenues by setting the "Target Revenues" to the most recent authorized revenues approved in each utility's most recent rate case.
2. The RAM mechanism shall be modified to include a cap that shall be applied to the total annual RAM Revenue Adjustment. The cap shall limit the

³Order No. 31908 at 49-50.

automatic component of RAM adjustment increases to an amount equal to or lower than the Gross Domestic Product Price Index ("GDPPI").

3. The 90% adjustment shall be removed in favor of the GDPPI cap.⁴
4. In order to provide a means for timely recovery of expanded capital programs, the Commission will allow the Companies to apply for approval by the Commission, on a case by case basis, to recover revenues outside of and in addition to the capped RAM revenues. The HECO Companies and the Consumer Advocate shall develop criteria for the commission's review for recovery of these costs (which may include consolidated or "programmatic" baseline expenditures) through the RAM or the Renewable Energy Infrastructure Program ("REIP") surcharge.

⁴With respect to recovery of revenues for capital projects, the amended RAM will thus allow continued automatic revenue recovery for capital project net plant additions in an amount effectively in rough approximation to the rate of depreciation and amortization on approved utility rate base, plus an increment of effective rate base indexed on general inflation. Beyond that, the amended RAM is intended to allow recovery of revenues for additional capital projects with prior approval by the commission.

5. The changes in Paragraphs 1 through 4 above shall be made effective on an interim basis pending commission resolution of the proceedings concerning the HECO Companies' PSIPs in Docket No. 2014-0183.
6. Given the pendency of several major proceedings, including the proposed merger of Hawaiian Electric Industries ("HEI") with NextEra Energy, Inc. ("NextEra"), the PSIPs, distributed energy resources, and demand response, the commission will not adopt Performance Based Ratemaking at this time.
7. The commission is establishing further issues for briefing.

The commission stresses that these changes are designed to provide the commission with control of and prior regulatory review over substantial additions to baseline projects between rate cases. This Order does not deprive the HECO Companies of the opportunity to recover any prudently incurred expenditures or limit orderly recovery for necessary expanded capital programs. Instead, the Order limits the amount of unapproved capital project expenditures that can automatically be incorporated into effective rates through the RAM without timely prior regulatory review.

II.

Background

On May 31, 2013, the commission issued Order No. 31289, initiating this investigation to examine whether the existing decoupling mechanisms, as approved by the commission in the "Decision and Order" in Docket No. 2008-0274 (the "Decoupling Docket"),⁵ effectively serve their intended purposes, are fair to the HECO Companies and the HECO Companies' ratepayers, and are in the public interest.⁶

Decoupling is generally described as follows:

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

⁵"Final Decision and Order and Dissenting Opinion of Leslie H. Kondo, Commissioner," filed on August 31, 2010, in Docket No. 2008-0274 ("Decoupling Order").

⁶Order No. 31289, "Initiating Investigation," at 1 ("Order No. 31289").

⁷"Order Initiating Investigation," filed on October 24, 2008, in Docket No. 2008-0274 ("Opening Order"), at 2-3.

On August 31, 2010, the commission issued its initial Decoupling Order in Docket No. 2008-0274, which approved the decoupling proposal set forth in the Joint Final Statement of Position, as amended, filed by the HECO Companies and the Consumer Advocate. In general, the Order approved the use of a decoupling mechanism for the HECO Companies, consisting of a Revenue Balancing Account ("RBA") and the RAM.

As discussed in the previous section, the RBA is the sales decoupling component, designed to break the link between the HECO Companies' sales and their total electric revenues by setting the Target Revenues ("Target Revenues") to the most recent authorized revenue level approved in each utility's most recent rate case. Thus, the annual RBA adjustment is the difference between each utility's Target Revenue and the recorded adjusted revenue, including monthly interest applied to the simple average of the beginning and ending month balances in the RBA.

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 revenues being separately tracked or recovered through any other surcharge or rate tracking mechanism, are excluded from the Target Revenue. The previous calendar year-end balance in the RBA (and the RAM Revenue Adjustment for the current calendar year discussed below) is recovered by way of a per kilowatt-hour ("kWh") RBA rate surcharge for both residential

and non-residential customers, assessed over the twelve months from June 1st of the current calendar year to May 31st of the succeeding calendar year.

As discussed above, the RAM is designed to "compensate the HECO Companies for increases in utility costs and infrastructure investment between rate cases" through formula-driven estimates. The components of the HECO Companies' revenue requirements that are subject to annual update and escalation through the RAM include: (1) changes in designated labor and non-labor operations and maintenance ("O&M") and payroll tax expenses; (2) the return on incremental investment in designated rate base components; (3) updated depreciation and amortization expenses; and (4) changes in costs due to significant changes in tax laws or tax regulations. The RAM for a current calendar year, along with the previous calendar year-end balance in the RBA, is recovered through the per-kWh RBA rate adjustment described in the preceding paragraph.

The commission approved a number of consumer protection features in the original Decoupling Order, including an Earnings Sharing Revenue Credit Mechanism and Credit Mechanisms for Major and Baseline Capital Projects. The commission also added certain modifications and conditions to the RAM to address the concerns that the commission and some of the parties had with respect to the RAM.

The commission also required a reduction in each of the HECO Companies' authorized rates of return ("ROR") to account for the reduced risk to the Companies from the implementation of decoupling. Moreover, decoupling could not actually be implemented until rates that reflected a reduced rate of return ("ROR") due to decoupling were approved by the commission in either an interim or final decision and order in the HECO Companies' pending rate cases.

The commission subsequently considered and approved adjusted RORs for each of the HECO Companies, and, therefore, allowed implementation of decoupling as follows:

- (a) Final Decision and Order, filed on December 29, 2010, in Docket No. 2008-0083 (HECO's 2009 test year rate case);
- (b) Decision and Order No. 30168, filed on February 8, 2012, in Docket No. 2009-0164 (HELCO's 2010 test year rate case);
- and (c) Decision and Order No. 30365, filed on May 2, 2012, in Docket No. 2009-0163 (MECO's 2010 test year rate case).

Since the initial approval of decoupling, HECO has submitted four annual decoupling tariff filings (2011, 2012, 2013, and 2014),

HELCO has submitted three such filings (2012, 2013, and 2014),⁸ and MECO has submitted two such filings (2013 and 2014).⁹

On May 31, 2013, in Order No. 31289, the commission initiated this investigation into the operation of the decoupling mechanisms, and clarified the distinct purposes of the RBA and the RAM:

Although both mechanisms are grouped administratively under the sales decoupling mechanism umbrella, each serves a different purpose. As noted in the Decision and Order in the Decoupling Docket, the primary purpose of the RBA is to de-link or "decouple" the HECO Companies' revenues from the amount of electricity or kWh sold to remove financial disincentives due to sales declines attributable to aggressive pursuit of Hawaii's clean energy mandates. The RAM, on the other hand, serves to compensate the HECO Companies for changes in utility costs and infrastructure investment between rate cases.¹⁰

On October 28, 2013, in "Order No. 31635 Identifying Issues, Establishing Procedural Schedule For Resolution Of Certain Issues, And Approving, With Modifications, The Parties' Joint Stipulated Procedural Order And Schedule For Resolution Of The Remaining Issues," the commission identified the

⁸HELCO's RBA Rate Adjustment for 2012 was negative, and, therefore, resulted in a reduction to customer bills.

⁹MECO filed its RBA Rate Adjustment schedules and workpapers in 2012 for informational purposes only.

¹⁰Order No. 31289 at 10.

specific issues to be addressed, and divided those issues into Schedule A Specific Issues ("Schedule A issues"), which were to be addressed on an expedited basis, and Schedule B Specific Issues ("Schedule B issues"), which are addressed in this Order.

On February 7, 2014, as previously noted, the commission issued Order No. 31908, in which the commission addressed the Schedule A issues, and directed the HECO Companies to make certain modifications to their decoupling mechanisms, including the 90% adjustment, and to include these modifications in their decoupling filings for March 31, 2014. The commission also deferred certain issues for consideration in a second phase of the proceedings, primarily associated with the posting of metrics on each Company's website. On March 11, 2015, the commission issued its "Order No. 32701 Approving The Release Of Performance Metrics, Directing That The Approved Performance Metrics Be Posted To The Websites, And Directing The Parties To Develop Additional Performance Metrics."

On May 20, 2014, the HECO Companies, the Consumer Advocate, the County Of Hawaii ("COH" or "County"), Hawaii Solar Energy Association ("HSEA"), Blue Planet Foundation ("Blue Planet"), and Hawaii Renewable Energy Alliance ("HREA") filed their initial statements of position ("Initial SOPs") with respect to the

Schedule B issues.¹¹ Each of these parties also filed reply statements of position on September 15, 2014 ("Reply SOPs"). Between the filing of Initial SOPs and Reply SOPs, information requests and replies were exchanged, and a substantial amount of data was produced by the HECO Companies.

A panel hearing before the commission was conducted on October 28 and October 29, 2014. In addition, the commission issued information requests to the Parties by way of "Order No. 32501 Amending Procedural Schedule And Issuing Information Requests," filed on December 9, 2014 ("Order No. 32501"). Each of the Parties responded to these requests on December 22, 2014.

Order No. 32501 also addressed the issue of further limited briefing by the Parties. In that Order, the commission stated that it would later issue an order "instructing the Parties regarding the issues and scope for limited briefs and reply briefs."¹² By this Order, the commission is establishing the limited issues for further briefing.

¹¹Unless otherwise indicated, in the remainder of this Order, the term "Parties" collectively refers to the HECO Companies, the Consumer Advocate, Blue Planet, COH, HREA, and HSEA.

¹²Order No. 32501 at 2.

III.

The Schedule B Issues

As noted above, in Order No. 31635, the commission set forth the general issues to be addressed in this docket. In addition, in order to provide further guidance to the Parties, the commission set forth detailed specific sub-issues with respect to each general issue. These issues are set forth in full in Appendix A to this Order and, thus, will not be repeated here.

In "Order No. 32415 Setting Issues, And Further Amending Schedule For Panel Hearing," filed on October 22, 2014 ("Order No. 32415"), the commission stated that it had reviewed the Schedule B Specific issues (as set forth in Appendix A to this Order), the Initial SOPs and Reply SOPs filed by the Parties, and the responses to various information requests. Based on that review, the commission simplified the issues for hearing as follows:

1. What, if any, performance incentives should be implemented as part of the Revenue Balancing Account ("RBA") and/or the Revenue Adjustment Mechanism ("RAM")?
2. Whether the RAM should be amended, terminated, or replaced?
3. What specific measures should or could be implemented to establish appropriate cost controls for baseline capital projects?

4. What, if any, of the proposed changes to ratemaking procedures should be pursued?¹³

This Order addresses all of the general and specific issues addressed in the course of this Docket. For purposes of clarity and focus, it should be noted that this Order generally addresses the Schedule B Specific Issues in the sequence set forth in Order No. 31635. Similarly, it addresses the issues identified for the Panel Hearing in sequence. While each issue and sub-issue is not always specifically identified in the various section headings, in rendering this Order, the commission considered each such issue and reviewed all of the extensive record in arriving at its conclusions herein.

IV.

General Principles Governing Review

As discussed throughout the Decoupling Order, the commission specifically retained the authority to review and/or terminate the decoupling mechanism at any time if the public interest so requires. For example, in Ordering Paragraph No. 7 of the Decoupling Order, the commission found:

¹³Order No. 32415 at 2.

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.¹⁴

Likewise, in discussing the adjustment to each utility's rate of return ("ROR"), the commission found:

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 commission has the authority to unilaterally discontinue the decoupling mechanism...¹⁵

¹⁴Decoupling Order at 131-132; see also at 122 and 128.

¹⁵Decoupling Order at 44.

Moreover, in discussing the ratepayer protections in the decoupling mechanism as approved, the commission found:

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.¹⁶

More generally, the rates and charges of regulated public utilities in Hawaii must be reasonable, and the commission has broad powers to investigate and examine the rates and practices of public utilities subject to its jurisdiction.¹⁷

V.

Discussion

A.

Performance Incentives

In this section of this Order, the commission addresses the issue of whether or not Performance Based Ratemaking ("PBR"), Incentive Based Ratemaking ("IBR"), or any Performance Incentive Mechanisms ("PIMs"), including "clean energy" PIMS, should be implemented at this time.

¹⁶Decoupling Order at 124.

¹⁷See, e.g., HRS §§ 296-6, 296-7, and 296-16.

Positions Of The Parties

Several proposals for performance incentives have been proposed by the Parties, either for immediate implementation to the existing RBA/RAM mechanisms or in conjunction with a broader implementation of PBR mechanisms.

Consumer Advocate The Consumer Advocate supports the use of PIMs that provide either incentives or penalties that are applied through an annual adjustment to RBA/RAM revenues.

Both metrics and performance incentives are important tools for regulators, but each plays a distinct role. Metrics enable regulators to monitor numerous aspects of utility performance to ensure no area is neglected. It is a policy decision to convert a metric into an incentive, often motivated by a utility's poor performance in a specific area or the need to balance a countervailing incentive. Specific objectives that may warrant clear financial incentives from the Commission at this time are identified below.

Over time, by monitoring the metrics established in Schedule A of this proceeding, it may be necessary to modify the list below to address newly identified performance deficiencies or objectives. As a general matter, the selection of appropriate goals or outcomes for performance incentives (penalties or rewards) should take into account any existing financial incentives that the utility has under its ratemaking mechanism. In addition, performance incentives should take into account the potential for creating perverse

incentives by emphasizing only a subset of desired outcomes.¹⁸

The Consumer Advocate quantified its incentives and penalties in terms of basis points associated with the HECO Companies' Return on Equity ("ROE"), although no change to each Company's ROE would actually occur.¹⁹ Instead, the HECO Companies would be permitted to recover, or required to refund, a dollar amount equivalent to the basis point penalty or reward at the same time as the annual decoupling adjustments are made, resulting in a reward or penalty with a duration of one year.²⁰

With respect to the actual incentives or metrics, as well as the basis points associated with each, the Consumer Advocate states that its proposed metrics address three major objectives: reducing customer costs, ensuring satisfactory levels of customer service, and maintaining reliable service.²¹ Thus, the Consumer Advocate proposes that the following metrics be implemented and coupled with a stated reward/penalty:²²

¹⁸CA Initial SOP-B at 7.

¹⁹CA Reply SOP-B at 32.

²⁰CA Reply SOP-B at 32.

²¹CA Reply SOP-B at 17.

²²CA Reply SOP-B at 33.

	Maximum Basis Point Equivalent Potential Reward	Maximum Basis Point Equivalent Potential Penalty
CONSUMER ADVOCATE METRICS:		
CUSTOMER COSTS		
Effective Planning and Management	25	-25
Results of Customer Surveys	20	-20
CUSTOMER SERVICE		
Customer Complaints	10	-10
Call Center Performance	10	-10
Orders And Appointments	10	-10
RELIABILITY		
SAIDI	0	-25
SAIFI	0	-25
TOTAL POSSIBLE	75	-125

Each of these metrics is discussed in depth in the Consumer Advocate's Initial and Reply SOPs.²³

As will be discussed in further detail in Section V.B., the Consumer Advocate "believes that the existing RAM dilutes rather than improves cost control incentives."²⁴

The Consumer Advocate submits that the cost control incentives faced by utility management in Hawaii are quite limited, because of the many cost-based rate adjustment mechanisms that exist and because of the reliance upon actual cost data to develop and revise rate case forecasts. The cost control incentives that exist are indirect, through a combination of regulatory lag incentives/penalties and because of the risk of potential regulatory prudence disallowances for any clearly excessive costs. Few direct cost control incentives or penalties exist because nearly all prudently incurred costs serve as the

²³CA Initial SOP-B at 12-19; CA Reply SOP-B at 17-32.

²⁴CA Initial SOP-B at 31.

basis for frequently increased cost-based utility rates. If nearly all costs are included in rates, the utility has little incentive to limit those costs.²⁵

Finally, with respect to more fundamental changes in how the HECO Companies are regulated, such as PBR or IBR, the Consumer Advocate states:

The Consumer Advocate is opposed to IBR at this time. The Consumer Advocate does not recommend Commission action on any of the broadly conceptual IBR recommendations that are employed in other jurisdictions in this Docket No. 2013-0141, because of the considerable additional work that would be required to determine, even preliminarily, whether any of these alternative regulatory frameworks are feasible for application in Hawaii.²⁶

Thus, the Consumer Advocate concludes that "[a] gradual movement toward IBR is encouraged by the Consumer Advocate," pursuant to the "[g]eneral design concepts for performance incentives measures ('PIMs') across multiple performance areas as outlined in the Consumer Advocate's [Initial SOP]."²⁷

With respect to this issue, the Consumer Advocate concludes:

The Consumer Advocate agrees that a comprehensive, new IBR plan cannot be designed within Schedule B of this Docket, but disputes the HECO Companies' conclusion that

²⁵CA Initial SOP-B at 32.

²⁶CA Reply SOP-B at 5 (emphasis in original).

²⁷CA Rely SOP-B at 10.

cost control incentives cannot be expanded at this time. Indeed, performance-based regulation is of heightened importance in periods when transformative change within the Hawaii utilities is ongoing and when major strategic investments are being planned and made. While more comfortable for the utilities, it is not essential that utility regulation adopt a "cost-plus" paradigm to achieve desired changes. The Commission is encouraged to adopt changes to the regulatory framework that insert appropriate performance incentive measures, strengthened cost-control incentives, and expanded REIS recovery for targeted investments, so as to move toward IBR in a measured and deliberate way.²⁸

Blue Planet Blue Planet proposes that the Commission adopt IBR that is focused on the increased utilization of clean energy in Hawaii, which Blue Planet refers to as "Hawaii Clean Energy IBR." Blue Planet states that "this model of regulatory reform offers the attributes essential to reshaping how the utility can prosper, and its customers can benefit, from the alignment of a sustainable utility business model with downward pressure on rates and the fulfillment of Hawaii's internationally-recognized commitment to a clean energy economy."²⁹ Blue Planet's proposal would completely restructure the current regulatory paradigm.

²⁸CA Reply SOP-B at 11-12.

²⁹Blue Planet Reply SOP-B at 2.

The basic elements of Blue Planet's proposal are as follows:

- Utility compensation will be tied to performance in achieving clean energy objectives, as measured through an "outcomes" report card supported by performance incentive mechanisms (and also potentially through more direct compensation for the provision of clean energy and related services),
- The historic cost of service regulatory model, including the relatively new rate adjustment mechanism approved in the first decoupling docket, will be phased out and replaced with Hawaii Clean Energy IBR,
- Utility generation, transmission and distribution, and customer service functions will be regulated through a revenue cap mechanism, with a tracker mechanism for large capital projects,
- A stakeholder process will be used to negotiate and reach agreement on a five year business plan which will describe the utility's specific clean energy commitments, the achievement of which may allow them to earn additional revenues, and
- The fossil fuel cost pass-through mechanism, which currently shields the utility from fossil fuel price fluctuations, will be modified and phased out.³⁰

³⁰Blue Planet Reply SOP-B at 2-3; Declaration of Ronald J. Binz at 11-27.

Blue Planet requests that its IBR proposal be adopted in this Docket, and that any commission order adopting their proposal should provide "guidance on key regulatory and policy issues," and establish "processes and procedures to guide stakeholder involvement in further developing this regulatory approach."³¹

Recognizing that its IBR proposal will take time to develop and implement, Blue Planet suggests that PIMs should be implemented immediately, although Blue Planet further observes that "the role of stand-alone PIMs may be supplemental and secondary to the extent this decoupling review results in changes to the regulatory and ratemaking process that essentially achieve the same objectives."³² In its Initial SOP, Blue Planet states that, regardless of the regulatory process, it favors implementation of PIMs that are consistent with HRS § 269-6(d).³³ Blue Planet describes the PIMs in its Initial SOP as tentative and subject to change.³⁴

³¹Blue Planet Reply SOP-B at 3-4.

³²Blue Planet Initial SOP-B at 22. With respect to regulatory changes, Blue Planet also asserts that, to achieve Hawaii's clean energy future, there should be differentiation of the business and regulatory models for the HECO Companies' generation and power supply operations, and their transmission and distribution operations. Id. at 2-3. Blue Planet further asserts that this proposal is consistent with Act 37, Session Laws of Hawaii (2013), which has been codified as HRS § 269-6(d). Id.

³³Blue Planet Initial SOP-B at 23.

³⁴Blue Planet Initial SOP-B at 23.

In its Reply SOP, Blue Planet states that "PIMs should be incorporated into the RAM prior to full implementation of Hawaii Clean Energy IBR and should subsequently be utilized to evaluate achievement with the outputs established pursuant to the approved business plan."³⁵ Thus, at this point Blue Planet proposes that the following four PIM metrics be implemented.

First, Blue Planet proposes a PIM metric that would reward the HECO Companies for reducing the carbon intensity of their generation, and for lessening the fossil content of their delivered energy.³⁶

To further the incentive to reduce fossil fuel use, I propose on behalf of Blue Planet a PIM that rewards the HECO Companies for lessening the fossil content of its delivered energy. The PIM would be defined as a change from a baseline trend that is already in place. I recommend that the "value" of the PIM be set large enough to be meaningful. Three cents on earnings per share ("EPS") might be a good target for the HECO Companies. Hawaii Electric Industries has about 100 million shares outstanding at the moment. An after-tax increase in earnings of three cents per share requires an earnings increase of about \$3 million after tax, or about \$4.5 million pre-tax. I would suggest that the incentive could be structured to be upside-only. In other words, the three-cents per share bonus would be the reward for achieving acceleration in reducing the fossil

³⁵Blue Planet Reply SOP-B at 13.

³⁶Blue Planet Reply SOP-B at 5.

content of the HECO Companies' generation in any given year.³⁷

Second, Blue Planet supports a PIM metric that measures customer service, and supports the Consumer Advocate's proposal with respect to this metric.³⁸ Third, Blue Planet also supports a PIM metric that measures reliability, and supports the Consumer Advocate's proposals concerning SAIFI and SAIDI in this regard.³⁹

Fourth, Blue Planet supports a PIM metric based on the interconnection and utilization of non-utility, non-fossil generation and demand response resources.⁴⁰

According to Blue Planet:

This metric is consistent with the "conditions for connection" utilized to measure and evaluate utility performance under the United Kingdom regulatory model known as "RIIO - Revenue set to deliver strong Incentives, Innovation and Outputs" ("RIIO"). As with the fossil fuel reduction PIM, the maximum reward or penalty would be valued initially at several cents per share for the HECO Companies.⁴¹

³⁷Blue Planet Reply SOP-B, Declaration of Ronald J. Binz at 39, Par. 106.

³⁸Blue Planet Reply SOP-B at 5.

³⁹Blue Planet Reply SOP-B at 6.

⁴⁰Blue Planet Reply SOP-B at 6.

⁴¹Blue Planet Reply SOP-B at 6.

HREA In both its Initial and Reply SOPs, HREA generally supports Blue Planet with respect to PIMs. Specifically, HREA supports "incorporation of performance incentives into the HECO Companies" RBA and/or RAM, "or other utility rate designs or ratemaking procedures."⁴² Thus, HREA strongly supports "investigation of the 'Iowa Model' as suggested by Blue Planet for organization and incenting of the generation functions, and the RIIIO Model for organization and incenting of transmission and distribution functions."⁴³ Finally, HREA recommends that the commission "consider an approach that ties all the incentives together, e.g., a report card for each company," that would provide the commission with more flexibility in its decision making.⁴⁴ HREA basically reiterates the same points in its Reply SOP, although it further states that any "new regulatory method, as well as any interim Performance Incentive Mechanisms, should not be developed and implemented until such time as there are Commissioned-approved HECO plans."⁴⁵

⁴²HREA Initial SOP-B at 2.

⁴³HREA Initial SOP-B at 3.

⁴⁴HREA Initial SOP-B at 3.

⁴⁵HREA Reply SOP-B at 3.

HSEA HSEA states that performance-based regulation or PIMS should address three "priority areas": reliability, cost, and clean energy."⁴⁶ HSEA states:

HSEA urges the Commission to move decisively from traditional cost-plus regulation to a new performance-based model, under which eventually all utility profits will be tied to performance... As one cornerstone of this new system, the Commission should establish outcomes or outputs for performance, including, at minimum: (1) Safety and Reliability; (2) Interconnection Quality; (3) Customer Service; (4) Environmental Performance; (5) Fossil Fuel Use Reduction; and (6) Customer Engagement... As another cornerstone, the Commission should provide for differentiated regulatory approaches for the HECO Companies' business functions of generation and "T&D"....⁴⁷

In order to accomplish this transition, HSEA proposes the following steps:

- 1) The Commission should issue a framework for performance-based regulation of the HECO Companies ("HI-PBR framework"), incorporating the outputs above ("HI-PBR outputs"). This HI-PBR framework, once implemented, will replace the current Revenue Adjustment Mechanism ("RAM") with a comprehensive performance-based system.
- 2) The HI-PBR framework will direct the Companies to produce HI-PBR plans, with full consultation with stakeholders, by a date certain. This may include a specific performance

⁴⁶HSEA Initial SOP-B at 14.

⁴⁷HSEA Reply SOP-B at 2-3.

incentive to encourage a timely and successful planning process.

- 3) The HI-PBR framework, and the resulting plans, will differentiate between the HECO Companies' generation and T&D business functions.
- 4) Pending the HI-PBR planning process, the Commission should take immediate interim steps to promote performance-based outcomes. These include:
 - a) Establishing an interim performance incentive mechanism tying a significant percentage of utility returns to the HI-PBR outputs. This necessitates requiring the HECO Companies to track and report their performance on the HI-PBR outputs, to the extent they are not already doing so.
 - b) Ensuring that any major investments in grid modernization such as smart grid infrastructure are tied to performance outputs and incentives for the delivery of actual benefits, including but not necessarily limited to the HI-PBR outputs.
 - c) Modifying the Energy Cost Adjustment Clause ("ECAC") to provide short and long term performance incentives to reduce dependence on imported fossil fuels and control fuel costs.

HSEA further explains that its PBR proposal is neither a substitute for decoupling nor a system of simple utility incentives. HSEA's witness explains:

As the ultimate end state for the new regulatory model, EDF recommends that 100 percent of utility profits should be tied

to performance, and that no portion of utility profits should be an entitlement apart from performance. In the transition to this end state, the principle should be that, the more utility earnings are tied to performance, instead of spending, the better...

This of course goes beyond decoupling, which simply serves as a short-term revenue stabilization mechanism and does not change the underlying ratemaking system. It also goes beyond entry-level, "traditional" PBR, which layers certain "targeted incentives" or "earnings sharing mechanisms" onto traditional ratemaking but keeps its underlying biases intact. So long as the fundamental incentive for utility capital investment remains, it will have a counteracting influence on any performance incentive mechanisms the Commission may establish.⁴⁸

With respect to PIMs, in its Initial SOP, HSEA states:

To mitigate concerns regarding the complexity of numerous incentives and metrics, the PIMs could adopt various approaches. For example, two levels of objectives could be developed, one with overall objectives and another with more specific, fine-tuned objectives to provide supplemental direction as necessary. Moreover, the PIMs could leave room for Commission judgment to alleviate the task of quantifying, weighing, and calibrating every objective and metric to an exact science in advance. For example, the determination of allowable ROE could be based in part on certain more readily quantifiable objectives, and in part on Commission judgment based on more qualitative objectives and factors. Alternatively, the PIMs could take a higher-level "report card" or "score card" approach, which could allow some discretion in the evaluation of performance (e.g.: "A" to

⁴⁸HSEA Reply SOP-B at 14-15.

"F"; Exceeds, Meets, or Fails Expectations), and/or the ultimate determination of rewards or penalties within a certain range.⁴⁹

HSEA states that it supports the clean energy PIM proposed by Blue Planet in the original decoupling docket as a first-level PIM that would address overall utility performance.⁵⁰ HSEA also supports PIMs that address reliability, such SAIDI and SAIFI,⁵¹ and that address fuel use.⁵²

With respect to generation and transmission and distribution ("T&D") facilities, HSEA states that in addition to utility-wide PIMs, "more specific incentive frameworks should address generation and T&D investments, including differential ranges of ROE to facilitate the evolution of the HECO Companies' business model." For example, HSEA suggests that a T&D-specific "cost-control" PIM could be developed "based on a plan and budget for investment developed in a transparent process," and that other T&D-specific PIMs could be developed to reflect how well investments promote a variety of objectives, such as lowering of

⁴⁹HSEA Initial SOP-B at 14-15 (footnote omitted).

⁵⁰HSEA Initial SOP-B at 15.

⁵¹HSEA Initial SOP-B at 16.

⁵²HSEA Initial SOP-B at 16-17. HSEA also presents comments on the Energy Charge Adjustment Clause ("ECAC") in this portion of its Initial SOP.

line losses, interconnection of customer-owned generation, and service.⁵³

In its Reply SOP, HSEA lists a variety of metrics that could be considered, including those related to safety and reliability, interconnection, customer service, environmental performance, fuel use reduction, and customer engagement.⁵⁴ HSEA also observes that the design of incentives can be flexible, that the incentives can have different weights, and that appropriate allowances can be made for metrics that the utility does not completely control.⁵⁵

The HECO Companies In their Initial SOP, the HECO Companies stated that they do not propose to implement an IBR Plan in this Docket.⁵⁶ According to the Companies, "[u]nder the current circumstances, modifications to the existing RAM, and the additional of targeted incentive mechanisms, are preferable to attempts to implement a broad-based IBR plan."⁵⁷

⁵³HSEA Initial SOP-B at 19-20.

⁵⁴HSEA Reply SOP-B at 19-20.

⁵⁵HSEA Reply SOP-B at 21.

⁵⁶HECO Companies Initial SOP-B at 37.

⁵⁷HECO Companies Initial SOP-B at 34.

In their Reply SOP, the Companies changed course:

The Companies can support the development of and transition to a new incentive-based regulatory ("IBR") model, with a target date for implementation of 2017. The Companies envision that this would be accomplished through a two-step or three-step approach to fully implement IBR.⁵⁸

Stated simply, the three steps are as follows. Under the first step, the HECO Companies would be permitted to maintain the RAM for the present, or would be required to incorporate certain IBR concepts into the RAM to "strengthen incentives to control costs, without creating unwarranted uncertainty with respect to the Companies' ability to recover prudently incurred costs as the business plans and model are initiated."⁵⁹

Under the second step, IBR would be partially implemented so as to "further drive efficiencies in the Companies' traditional business activities."⁶⁰ Thus, "the initial scope of the IBR plan would be limited to those parts of the Companies' business that are relatively well-understood, where the level and type of activity in the future is relatively similar to the past, and where it is relatively easy to measure delivery."⁶¹

⁵⁸HECO Companies Reply SOP-B at 48 and 113.

⁵⁹HECO Companies Reply SOP-B at 48.

⁶⁰HECO Companies Reply SOP-B at 48.

⁶¹HECO Companies Reply SOP-B at 48.

According to the Companies, it would not be appropriate to include new business plan activities due to their uncertain nature and the possibility of a shift in priorities.⁶²

Under the third step, the HECO Companies state that "with experience and sufficient investment in design and development, IBR plans can include mechanisms to deal with the kinds of uncertainty associated with the Companies' new business plans."⁶³ Despite this statement, however, the Companies state that "[t]he scope of the IBR plan initially would be limited to the Companies' traditional activities, with new business plan activities funded through separate mechanisms."⁶⁴

The HECO Companies then describe their "refined" IBR proposal:

The Companies' refined IBR concept is delineated in Exhibit C to this Reply SOP. It is a base revenue cap mechanism. Incorporating the numerous lessons learned from others who have successfully implemented IBR over the past decades, the IBR mechanism explicitly addresses the impact of capital investments separately from operating expenses. Additionally, the Companies' IBR concept excludes exogenous events (and costs) outside of the Companies' control, and includes complimentary incentive

⁶²HECO Companies Reply SOP-B at 49.

⁶³HECO Companies Reply SOP-B at 49.

⁶⁴HECO Companies Reply SOP-B at 49.

mechanisms to share earnings and to maintain or improve service quality.⁶⁵

With respect to PIMs, the HECO Companies state that "[o]nce transition to IBR is accomplished, the Companies support and have proposed service quality performance metrics that would be implemented as part of the plan."⁶⁶ As part of a "Targeted Incentive Plan," the HECO Companies propose the following performance incentives:

- With respect to reliability measures, the Companies propose to utilize SAIDI and SAIFI, and further recommend "that the SAIDI and SAIFI TPIs be further specified so that they reflect normalized transmission and distribution (T&D) data for each of the three operating companies."⁶⁷
- With respect to customer service, the Companies propose "Transaction Satisfaction" and "Service Level" metrics because they are representative of customer experiences with the Companies.⁶⁸ The Companies further explain:

Transaction Satisfaction comes closest to providing an encompassing indicator of customer service scores because it reflects customer opinions concerning a range of more specific customer service measures. Service Level is a more specific measure, but reflects an important and highly visible point

⁶⁵HECO Companies Reply SOP-B at 51. As noted, the proposal is full set forth in Exhibit C to the Reply SOP.

⁶⁶HECO Companies Reply SOP-B at 11.

⁶⁷HECO Companies Reply SOP-B, Exhibit F at 8.

⁶⁸HECO Companies Reply SOP-B, Exhibit F at 8.

of interaction between customers and the utilities.⁶⁹

With respect to the level of incentives, the Companies state:

We recommend that a maximum revenue exposure for the Companies under a TPI plan could be set at roughly 1.5% or 2.0% of estimated T&D cost of service revenue requirements, and that these estimates be used to set specific dollar incentive amounts. We also recommend that the Commission consider setting the maximum penalty/reward for reliability at 70% of the total revenue exposure, evenly split with 35% assigned to SAIDI and 35% to SAIFI. The remaining 30% of the maximum penalty/reward should be evenly allocated among the TPIs associated with customer service.⁷⁰

The HECO Companies also appear to recommend that the penalties and rewards be symmetric.⁷¹

2.

Commission Findings And Conclusions

1. At the outset, the commission observes that there is a distinction between "PBR framework" proposals and

⁶⁹HECO Companies Reply SOP-B, Exhibit F at 9.

⁷⁰HECO Companies Reply SOP-B, Exhibit F at 10-11.

⁷¹HECO Companies Reply SOP-B, Exhibit F at 11.

"stand-alone" PIMs.⁷² As discussed above, the parties have, to a greater or lesser degree, offered proposals with respect to both.

2. The proposed PBR frameworks, if implemented, would constitute a wholesale change in the regulatory procedures and cost control incentives associated with the traditional ratemaking process by, among other things, allowing utilities to profit from realized cost efficiencies and establishing financial rewards or penalties based on utility performance according to specific incentive metrics. As discussed below, there are distinct differences among the performance incentive framework proposals by the parties.

3. For example, the HECO Companies describe their "refined" IBR proposal as a base revenue cap mechanism that addresses the impact of capital investments separately from operating expenses, excludes exogenous events and costs that are outside of the Companies' control, and includes complementary incentive mechanisms to share earnings and to maintain and improve costs.⁷³ Blue Planet's IBR proposal would tie the HECO Companies' performance to the achievement of clean energy objectives,

⁷²When the commission refers to the "PBR Framework" in this discussion, the commission is referring collectively to the PBR and IBR proposals of the parties that, if implemented, would substantially change existing ratemaking procedures as opposed to amending the RAM.

⁷³HECO Companies Reply SOP-B at 51 and Exhibit C.

as measured through an "outcomes" report card supported by performance incentive mechanisms, and would phase out traditional regulation in favor of a revenue cap mechanism, with a tracker mechanism for large capital projects.⁷⁴ Blue Planet would also eliminate tracking mechanisms for fossil fuels. HSEA proposes a transition to a new regulatory model, in which 100 percent of utility profits are tied to performance, and where all utility profits are dependent on performance.⁷⁵

4. On the other hand, the Consumer Advocate states that it is opposed to IBR at this time, and does not favor the implementation of any of the conceptual IBR plans implemented in other jurisdictions given the additional resources necessary to determine whether or not such a proposal is feasible for Hawaii.⁷⁶

5. Stand-alone PIMs provide financial rewards or penalties for utility performance according to specific metrics but without necessarily adopting a substantial change in other ratemaking procedures. Generally, as has been suggested by parties in this docket, the performance incentive metrics and/or mechanisms proposed in conjunction with the

⁷⁴Blue Planet Reply SOP-B at 2-4; Declaration of Ronald J. Binz at 11-27.

⁷⁵HSEA Reply SOP-B at 2-3, 14-15.

⁷⁶CA Reply SOP-B at 5.

PBR framework proposals could also be implemented in some form as stand-alone PIMs.

6. There is also a distinction between "conventional" PIMs designed to ensure maintained quality of services to customers, and "energy policy" PIMs designed to promote attainment of energy policy objectives. Most PBR frameworks incorporate conventional PIMs to ensure that the cost control incentives of the PBR framework do not encourage the utility to obtain cost reductions by reducing the quality of services provided to customers. Conventional PIMs reward or penalize a utility based on performance according to one or more conventional service quality metrics.

7. In this proceeding, several conventional PIMs were proposed by parties, either in conjunction with PBR proposals or as stand-alone PIMs. Examples of these include such metrics as SAIDI, SAIFI, and measures related customer complaints and call center performance, as proposed by the Consumer Advocate and others.

8. Several energy policy PIMs were also proposed which encourage the utilities to meet or exceed objectives generally consistent with State "clean energy" policies. Examples of these include metrics that (a) reward the HECO Companies for reducing the carbon intensity of their generation, and for lessening the fossil content of their delivered energy;

and (b) measure the interconnection and utilization of non-utility, non-fossil generation and demand response resources.

9. For the following practical reasons, the Commission will not implement a PBR framework or any of the proposed stand-alone energy policy PIMs at this time in this docket.

10. It is clear that with all of the proposed PBR proposals and PIMs, care must be taken regarding the details of the performance metrics and mechanisms in order to ensure that the mechanisms are effective, are not subject to excessive gaming and do not produce unintended deleterious consequences.

11. The commission next observes that the HECO Companies are in a period of exceptional transition with major strategic and resource planning uncertainties unresolved. While these issues will not be addressed in depth in this Order, the commission notes that the following major dockets are currently pending: (a) a review of the PSIPs filed by the HECO Companies, which address critical power supply resource issues, including serious deficiencies in planning and operational practices as renewable energy levels increase on each system (Docket No. 2014-0183); (b) a review of the HECO Companies' Distributed Generation Interconnection Plans ("DGIPs"), as well as a broader review of Distributed Energy Resources ("DER"), in order to develop technical solutions and action plans to increase the capability of the HECO Companies' distribution systems to

interconnect additional distributed energy (Docket No. 2014-0192); and (c) a review of the HECO Companies Integrated Demand Response Portfolio Plan ("IDRPP") (Docket No. 2007-0341). Other issues currently facing the HECO Companies include an examination of whether inter-island power transmission via undersea cable may be in the public interest, and whether the increased use of liquefied natural gas ("LNG") can assist in reducing rates and meeting clean energy goals. In addition, major rate cases are pending for both HECO (Docket No. 2013-0373) and MECO (Docket No. 2014-0318).

12. In addition to these dockets, the commission must decide whether or not to approve a proposed change of corporate control of the HECO Companies (Docket No. 2015-0022). While that review will take place independently of the resolution of the other dockets set forth above, the commission is nevertheless aware of the major impact such a change could have on the operation of the HECO Companies.

13. Without clearly defined and accepted utility strategic plans in place, it is difficult to bring desirable tactical objectives into clear enough focus to devise effective performance incentives without the risk of unintended consequences.⁷⁷

⁷⁷The commission notes that COH proposes elimination of the RBA and RAM mechanisms, in part, to remove inappropriate disincentives for cost control. COH Initial SOP-B at 4-5.

14. For example, the PSIPs currently under review constitute a major analysis of the HECO Companies' generation, transmission, and distribution systems going into the future. Aside from questions concerning the maintenance, replacement, upgrade, retirement, or modification of these various system components, there are additional issues such as the affordability of the proposed plans, and to what extent, if any, the timeline for cost-savings measures can be expedited. Until such decisions are made, or, at the least, a clear path forward is identified, attempts to incentivize utility behavior may be misdirected or worse, counterproductive.

15. DER issues and the DGIP are being addressed in Docket No. 2014-0192. Simultaneously with this Order, the commission is issuing an initial order and Staff Report and Proposal in that Docket to provide guidance to the parties in reviewing the issues associated with DER and the DGIP. Again, pending resolution of these issues, implementation of a PBR framework is premature.

16. For the same reasons, it is not clear that clean energy PIMs indexed on reductions in fossil-fuel use or carbon emissions would provide appropriate incentives to encourage the utilities to reach optimal decisions, nor is it likely to be feasible to establish effective and fair quantitative thresholds

to characterize sufficient or deficient utility performance and associated rewards or penalties.

17. In the future, as the major decisions regarding pending resource plans, business plans, and the functional roles of the utilities are more clearly determined, the commission will further consider the implementation of PBR frameworks and stand-alone energy policy PIMs.

18. The commission does recognize the merit of conventional PIMs to ensure adequate service quality in conjunction with effective incentives to the utilities to reduce costs. In this Order, the commission directs the parties to file briefs and reply briefs regarding the refinement and implementation of the conventional PIMs proposed by the Consumer Advocate and similar conventional PIMs proposed by the HECO Companies and other parties, as set forth above. The commission reiterates that it will not give further consideration to energy policy PIMs, as distinguished above, in this docket.

B.

Changes To The RAM

As set forth in Order No. 31635, Schedule B Specific Issues #6 and #7 address the following general issues:

6. What changes or alternatives to the existing RAM would be appropriate to address the issues identified above?

7. What corollary matters need to be addressed if the RAM is substantially amended or terminated as a result of Commission order or otherwise in this proceeding?

The sub-issues for Issue #7 are set forth in Appendix A to this Order. The commission further observes that elements of Issues #1, #2, #3, and #4 are addressed in this Section.

1.

Introduction

In Order No. 31908, the commission noted that all of the parties appeared to support the baseline project provisions in the existing RAM.⁷⁸ The commission further observed that the Consumer Advocate and, to some extent, the HECO Companies, acknowledged that baseline project expenditures that have not been subject to previous review or approval by the commission are included in the calculation of RAM Revenue Adjustments.⁷⁹ Despite this recognition, the commission found that "[n]one of the parties advocate that the commission order any changes to the current tariffs in this order."⁸⁰

⁷⁸Order No. 31908 at 44, Issue #2, Finding (3.).

⁷⁹Order No. 31908 at 44, Issue #2, Finding (3.).

⁸⁰Order No. 31908 at 46, Issue #2, Finding (6.).

Notwithstanding the parties' positions in the Schedule A proceedings, the commission found that "the continued application of the current Rate Base RAM tariffs does not result in rates that are just and reasonable as it does not incentivize cost control."⁸¹ The commission ordered certain modifications to the tariffs as an interim measure, and directed the parties to further explore the issues regarding baseline project provisions in the proceedings regarding the Schedule B issues.⁸²

In response to the commission's directives, the parties here provided several options to address the concerns maintained by the commission regarding the need to make changes to the RAM. Notwithstanding the parties' proposal of specific options, the commission recognizes that the parties have not explicitly changed their positions and none are assertively advocating changes to the RAM in this proceeding. Given this, the specific options for changes to the RAM proposed by the parties in both the Schedule A and Schedule B phases of this proceeding are discussed in the context of the commission's findings below.

⁸¹Order No. 31908 at 48, Issue #2, Finding (9.).

⁸²Order No. 31908 at 48, Issue #2, Finding (9.).

2.

Commission Findings And Conclusions

a.

Commission Concerns With,
And The Need For Changes To, The RAM

19. At the outset of this proceeding, the commission indicated its intent to continue a sales decoupling mechanism, that is, the RBA mechanism.⁸³ The RBA mechanism is designed to ensure that the HECO Companies will recover approved revenues, no more and no less, regardless of changes in sales, demand, or other circumstances. In this Order, the commission affirms that the RBA mechanism shall be retained in its present form, except as may be necessary to implement the specific changes to the RAM mechanism ordered herein.

19. The commission further indicated, however, that the RAM mechanism, which is designed to adjust the level of approved revenues between general rate cases, warrants thorough examination.⁸⁴ Several concerns have been identified by the commission regarding the RAM mechanism in the order initiating this investigatory proceeding and in several orders specifying the general and specific issues.

⁸³Order No. 31289 Initiating Investigation, filed May 31, 2013, at 10 ("Order No. 31289").

⁸⁴Order No. 31289 at 10.

20. Several concerns were identified at the outset of this proceeding in Order No. 31289, Initiating Investigation. One of the initial general issues identified in the Order was:

2. INCENTIVES TO CONTROL COSTS: Whether the decoupling mechanisms, in conjunction with the present reliance on multiple automatic rate recovery and tracking mechanisms, sufficiently maintain and enhance incentives for the HECO Companies to control costs?⁸⁵

21. In discussing that general issue in Order No. 31289, the commission elaborated on its concerns about cost control generally and identified specific concerns regarding the treatment of baseline capital expenditures in the RAM:

[I]n conjunction with other automatic rate adjustment mechanisms, the decoupling mechanisms essentially ensure that the HECO Companies will recover all entitled revenues regardless of virtually all circumstances that would otherwise effect utility sales and revenues. The HECO Companies are therefore not subject to a broad category of risks that might otherwise serve to incentivize diligent control of company expenses. With the recent persistent decreases in utility electric sales volumes, for example, the HECO Companies do not, by any discernible indications, appear to feel financially compelled to implement corresponding decreases in utility expenses to the extent that would occur with declining net revenues. Indeed, HECO's 2013 decoupling tariff filing and associated automatic rate adjustment reflects considerable increases in expenditures on investments in total plant compared to prior years, even with declining electricity sales.

⁸⁵Order No. 31289 at 13.

Of particular concern regarding the recent trend of HECO's increasing expenditures for utility plant, is that the majority of the expenditures appear to be related to baseline projects that are not subject to any prior commission review and approval process, in contrast to major capital projects that are subject to the commission's General Order No. 7, Standards for Electric Utility Service in the State of Hawaii. In addition to the subject of incentives for cost control generally, one specific issue for examination in this investigation is whether this aspect of the functioning of the RAM, combined with the fact that there is no prior commission review and approval of baseline expenditures before they are incorporated in effective rates, is reasonable and in the public interest.⁸⁶

22. In Order No. 31289, the commission observed that HECO's 2013 decoupling tariff filing reflected considerable increases in total plant investments (including baseline and major project plant additions) since HECO's first decoupling filing - jumping from \$170 million in 2011, to \$256 million in 2012 (\$86 million increase from 2011), and to \$292 million projected for 2013 (projected \$36 million increase from 2012).⁸⁷

23. One of the Schedule A issues identified in Order No. 31635 addressed the "REASONABLENESS OF AUTOMATICALLY INCLUDING ALL ACTUAL PRIOR YEAR EXPENDITURES ON BASELINE PROJECTS

⁸⁶Order No. 31289 at 13-14.

⁸⁷Order No. 31289 at 14, footnote 18.

IN RAM RATEBASE".⁸⁸ As set out in its subparts, that issue was designed to examine whether the RAM mechanism allows recovery of revenues for expenditures not previously reviewed and approved by the commission, whether those provisions are consistent with the principles considered in the Decoupling Docket, whether that aspect of the RAM is reasonable and in the public interest, and whether there are feasible alternatives to address identified concerns.

24. One of the three general Schedule B issues identified in Order No. 31635 is as follows: "WHETHER THE RAM MECHANISM SHOULD BE AMENDED, TERMINATED OR REPLACED."⁸⁹ Several specific issues and sub-issues are also identified which refer generally to: (a) what changes should be made to the RAM to address several other identified issues, including incentives for cost control and incentives to amend and maintain timely and appropriate strategic plans and action plans; and (b) what matters should be considered if the RAM is substantially changed.

25. In Decision and Order No. 31908 addressing Schedule A issues, the commission recounted in some detail the parties' positions with respect to concerns regarding the

⁸⁸Order No. 31635 at 7-8.

⁸⁹Order No. 31635 at 18-19.

treatment of baseline projects in the RAM.⁹⁰ The detailed recounting of the parties' positions in the Order No. 31908 will not be repeated here. Based on its review of the record and recommendations of the parties regarding the Schedule A issues, the commission found and concluded, in part:

1. As discussed in Order No. 31289, the commission has serious concerns regarding the recent trend of HECO's increasing expenditures for utility plant. As stated previously, the majority of the expenditures are related to baseline projects that are not subject to prior commission review and approval, unlike major capital projects that are subject to the commission's General Order No. 7. Given this fact, the commission has serious concerns about whether the HECO Companies have the appropriate incentives to minimize these costs.

2. Indeed, in the recent Decision and Order pertaining to MECO's rate case, the commission expressed concern that, without a sustainable business plan, there was no strategic framework under which to evaluate capital expenditure programs:

From the commission's perspective, the HECO Companies appear to lack movement to a sustainable business model to address technological advancements and increasing customer expectations. The commission observes that some mainland electric utilities have begun to define, articulate and implement the vision for the "electric utility of the future." Without such a long-term, customer focused business strategy, it is difficult to ascertain whether

⁹⁰Order No. 31908 at 32-42.

HECO Companies' increasing capital investments are strategic investments or simply a series of unrelated capital projects that effectively expand utility rate base and increase profits but appearing to provide little or limited long-term customer value. While a public utility is required to have a reasonable opportunity to earn a fair financial return, attractive financial returns are not an entitlement by virtue of being a regulated utility.⁹¹

26. In its Order No. 31908, the commission also observed that certain aspects of concerns regarding cost control incentives are unique to the Rate Base Ram component of the RAM:

8. The commission observes that Rate Base RAM is the only component of the decoupling mechanisms that is indexed on utility expenditures, with the result that increased expenditures directly result in increased allowed revenues. In sharp contrast, the RBA and O&M RAM are based on approved revenues indexed on factors that do not vary as a result of the amount of utility expenditures. The RBA and O&M RAM components of the decoupling mechanisms thus preserve one of the facets of traditional ratemaking: that reductions in utility expenditures between general rate cases (i.e., cost control) result, on the margin, in increased utility earnings. This is not the case for Rate Base RAM, particularly the baseline capital component, which allows incremental utility expenditures to flow directly through to incremental RAM revenues,

⁹¹Order No. 31908 at 42-44, quoting, "In the Matter of the Application of MAUI ELECTRIC COMPANY, LIMITED, For Approval of Rate Increases and Revised Rate Schedules and Rules," Docket No. 2011-0092, Decision And Order No. 31288, filed May 31, 2013, Exhibit C, Commission's Observations and Perspectives, page 3 of 6 (footnote from the original).

thus removing this incentive to the utility to control costs.⁹²

27. As previously noted, in Order No. 31908, the commission ordered the HECO Companies to revise their decoupling tariffs to provide that the amount of any "Rate Base RAM - Return on Investment Adjustment" ("Rate Base RAM Adjustment") applied to the determination of Target Revenues and the RBA Rate Adjustment in accordance with the existing RAM tariffs shall include the entire effective Rate Base RAM Adjustment from the prior year, plus ninety percent of the amount that the current RAM Period Rate Base RAM Adjustment exceeds the Rate Base RAM Adjustment from the prior year.

28. The commission observes that, since the time that the RAM mechanism was implemented, the HECO Companies' baseline capital expenditures have increased dramatically and have become the largest component of decoupling revenue increase adjustments. Baseline expenditures for the consolidated Companies have increased from \$161 million in 2009 to \$368 million in 2013.⁹³ The Companies have proposed, in their pending PSIPs, an unprecedented and dramatic capital expenditure plan including

⁹²Order No. 31908 at 47, Issue #2, Finding (8.).

⁹³Baseline expenditures reported in the Companies' 2014 decoupling submittals have increased from \$94 million in 2009 to \$254 million in 2013 for HECO, from \$33 million in 2009 to \$55 million in 2013 for MECO, and from \$34 million in 2009 to \$59 million in 2013 for HELCO.

more than \$2 billion in capital expenditures in the next three years.⁹⁴ Based on the commission's initial review of the proposed PSIPs, it appears that a majority of the proposed capital expenditures may be baseline expenditures not subject to review as Major Projects subject to prior General Order 7 review. Pursuant to the decoupling mechanism, the examination of these expenditures might be deferred for an extended period of time.

29. Without approved integrated resource plans, PSIPs, or any other clear, well-vetted strategic plans, and without timely rate cases to provide normal opportunities for periodic review, the Commission has scant assurance that the extensive planned capital expenditures are prudent and affordable. The RAM was not originally intended, nor is it reasonable to continue to function, as a mechanism by which such unprecedented levels capital expenditures are allowed to enter utility rate base without effective, timely regulatory review. The RAM was certainly not intended to serve as a means to circumvent appropriate and timely regulatory review of utility expenditures or as a substitute for thoroughly vetted comprehensive resource plans.

⁹⁴See: Totals of capital expenditures for the years 2015 through 2017 as documented in Appendix K for each of the Companies' PSIPs filed on August 26, 2014, consolidated for review in Docket No. 2014-0183. The commission takes official notice of the record in Docket No. 2014-0183 pursuant to HAR §§ 6-61-47 and 6-61-48.

30. For the reasons set forth above, and based on a review of the entire record in the Schedule A and Schedule B phases of this proceeding, the commission confirms its previous conclusion in the Order No. 31908 that "the continued application of the current Rate Base RAM tariffs does not result in rates that are just and reasonable."⁹⁵ Changes to the RAM are clearly necessary.

b.

Options To Address Identified Concerns
Regarding Baseline Projects In The RAM

31. As noted above, at the outset of this proceeding, the commission identified its concerns regarding whether the RAM provides appropriate cost control incentives and, in particular, its concerns regarding the baseline project provisions in the Rate Base RAM. Pursuant to the statements of issues in both the Schedule A and Schedule B parts of this proceeding, the parties were encouraged to address these concerns and provide suggested remedies. Although none of the parties took assertive positions that the RAM should be changed, in response to the commission's identified concerns, several parties responded with alternate proposals as discussed below.

⁹⁵ Order No. 31908 at 48, Issue #2, Finding (9.).

(1)

Adjustments To The RAM Identified By The Parties
To Address Baseline Expenditures

32. In the Schedule A proceedings, the HECO Companies proposed to expand the process for annual reporting on the level of baseline capital expenditures, as summarized in their Schedule A Reply SOP:

To facilitate the review of baseline capital expenditures and plant additions in the capital expenditures budget presentations, and to provide an opportunity for the Commission to provide feedback on the proposed level of expenditures, the Companies have developed a proposed iterative process for future presentations. The proposed process is described in Exhibit 2 to the Companies' SOP. A key element of the proposed process is the provision of more detailed information on baseline projects, included estimated revenue requirement impacts, and the provision of such information at a much earlier date so that the Companies can make adjustments based on the feedback if appropriate.⁹⁶

33. During oral argument addressing Schedule A issues, the Companies clarified that they viewed this proposal as a quasi-pre-approval of baseline projects. (HECO Companies, Schedule A, Tr. 55). The commission rejected this position in Order No. 31908:

The commission appreciates the HECO Companies' proposal to discuss providing the commission and the parties with more detailed information on baseline projects, including estimated

⁹⁶HECO Companies Reply SOP-A at 18.

revenue requirement impacts, and to provide such information at a much earlier date so that the Companies can make adjustments based on any feedback, if appropriate. However, the commission stresses that the provision of such information in no way should be construed as any type of quasi- or pre-approval of baseline projects. Approval of such projects remains an issue to be addressed in full rate case proceedings.⁹⁷

34. Also in the Schedule A proceedings, the Consumer Advocate identified possible options to address the commission's concerns regarding baseline projects. One alternative that the Consumer Advocate identified but did not then assertively advocate, was a modification to the RAM that would use general inflation rate limitations to cap increases in overall RAM Revenue Adjustment increases.

Notwithstanding the effort placed on development of the existing RAM rate base procedures, the Consumer Advocate believes that there are alternatives that might be considered to modify and improve upon the existing RAM Rate Base methodologies. It may be feasible, for example, to consider limiting either the overall RAM increase or certain of the discrete elements of RAM to some measure of general inflation each year, so as to strengthen the financial incentives for utility management to carefully manage costs between rate case test years. This would be an expansion of the current use of GDPPI to provide for non-labor expense increases in calculating RAM adjustments.⁹⁸

⁹⁷Order No. 31908 at 35.

⁹⁸CA Final SOP-A at 20.

35. The Consumer Advocate advised caution regarding this approach and, more generally, notes potential effects of imposing limitations on the RAM adjustments.

Any modification to RAM that imposed generalized inflation rate limitations could help to protect ratepayers from outsized target revenue increases, assuming general rates of inflation remain moderate. However, such modifications would also increase the risk that sustained utility cost increases above general rates of inflation would reduce the utility's financial performance to unacceptable levels and expose ratepayers to more frequent and larger general rate cases, or both. Alternatively, if actual utility costs in some future years increase at below-inflation rates, such an approach may overstate required RAM rate adjustments.⁹⁹

36. In its Final SOP in the Schedule A proceedings, the Consumer Advocate also identified an approach to implement cost controls generally by a mechanism to adjust utility ROE based on whether revenue requirement increases are maintained within the bounds of general inflation.

One remaining problem with the RAM in its present form is the allowance of the same ROE each year, regardless of management efficiency or resulting rate and service quality levels. The Consumer Advocate continues to favor the thoughtful development of an alternative regulatory framework that provides an opportunity for the utility to earn relatively higher ROE levels whenever the calculated overall revenue requirement change each year is constrained to not exceed general inflationary levels, but lower ROE levels

⁹⁹CA Final SOP-A at 20.

whenever overall utility costs are not controlled within such general inflationary boundaries. Such variable returns should be designed to share the benefits of utility cost controls, but must also be tempered by appropriate service quality performance and clean energy achievement metrics that are under consideration by the Commission in this Docket (see Section D, below). However, the Consumer Advocate is concerned that the implementation of a significantly revised alternative regulatory framework for the HECO Companies, based upon new financial and performance measures and calculations methodologies, that has not been thoroughly vetted, may result in unintended and/or undesirable consequences.¹⁰⁰

37. In the Schedule A proceedings, the Consumer Advocate also indicated a willingness to further develop a mechanism using adjustment(s) of ROE based on utility cost control performance.

The Consumer Advocate believes that it may be possible to revise the existing RAM calculations to provide for a variable and somewhat higher ROE when overall revenue requirement increases are lower than general inflation, and vice versa when unreasonably large cost increases are experienced, assuming that service quality and other measures of utility performance do not deteriorate as a result of cost control measures that are stimulated by regulatory changes. The Consumer Advocate is willing to work collaboratively toward a carefully designed and calibrated variable ROE approach to rebalance ratepayer and shareholder interests, that does not adversely affect the HECO Companies' ability to offer reliable, safe and reasonably priced utility service

¹⁰⁰CA Final SOP-A at 24.

while maintaining utility access to capital on reasonable terms.¹⁰¹

38. The Consumer Advocate further developed the concepts identified in both the alternative to utilize an index of general inflation to limit RAM Revenue Adjustments and the alternative to use adjustments to ROE as part of an incentive mechanism, in its PBR proposal presented in the Schedule B part of this proceeding.

39. In the Schedule B proceedings, the HECO Companies presented two alternative options for modifying the existing RAM in order to "address the commission's concerns with respect to the limited review of baseline capital project additions prior to the inclusion of the costs for such projects in the Rate Base RAM - Return on Investment component, and the limited incentives in the RAM to control baseline capital project costs."¹⁰²

40. The HECO Companies' first alternative would incorporate the "enhanced" process for "review" of capital projects in annual presentations to the commission previously discussed with respect to the Schedule A proceeding. According to the Companies, the enhanced process would provide more detailed information, earlier presentation, and opportunity for

¹⁰¹CA Final SOP-A at 25-26.

¹⁰²HECO Initial SOP-B at 39-40. The alternatives are discussed in HECO Initial SOP-B at 37-47, HECO Initial SOP-B Exhibit C at 12-22, and HECO Reply SOP-B at 21-28.

the companies to make adjustments based on "feedback" from the commission.

41. In addition to the review process, for the first alternative, the HECO Companies present two options to provide incentives to the Companies to control costs. Option A would provide for a target for the amount of baseline additions which would be "added to the beginning of year rate base to determine the year-end rate base for the RAM period."¹⁰³ The target would be determined by the commission in September of the year prior to the effective RAM period. To serve as an incentive for the companies to control costs, any "savings or overages" below or above the target would be "shared 50/50 between the Companies and customers."¹⁰⁴ A cap on the incentive or penalty to the Companies was proposed at "\$5 million for all of the Companies (approximately equal to five cents in earnings per share)."¹⁰⁵

42. Option B would maintain the existing methods for determining the Rate Base RAM, but would provide an incentive mechanism that would reward or penalize the Companies based on an incremental revenue requirement target for each Companies' upcoming RAM year Rate Base RAM increase. The targets and the

¹⁰³HECO Initial SOP-B at 43.

¹⁰⁴HECO Initial SOP-B at 43.

¹⁰⁵HECO Initial SOP-B at 43.

methods for setting the targets would be determined by the commission prospectively in a rate case. Savings or overages below and above the target would be "shared" between the Companies and customers with a \$5 million cap for all of the Companies.

43. Option A and, apparently, option B would maintain the current provisions to "true up" actual plant additions, depreciation and amortization, Contributions In Aid Of Construction "CIAC," and Accumulated Deferred Income Taxes ("ADIT") in the beginning of year rate base in subsequent Rate Base RAM calculations.

44. The second alternative proposed in the HECO Companies' Initial SOP-B and Reply SOP-B is described as follows:

For Alternative 2, a rate case forecast of net baseline plant additions would be approved for the test year. Then, in real dollar terms, new plant additions (net of CIAC) in each subsequent year would be capped at the test year level. The test year net baseline plant additions would be escalated only for capital-related construction costs using the Global Insight Utility Capital Cost Escalation factors (using factors most applicable to Hawaiian Electric) in effect at the time of the Commission decision. Under this alternative, any underspending for baseline plant additions over the three year period between rate cases would be returned to customers. Plant additions for major capital projects scheduled to be in-service by the end of September of the RAM period would be added to the RAM period rate base at authorized levels, with a true-up to actuals (not to exceed authorized levels) plus

interest occurring in the subsequent year's RAM period filing. (O&M would be handled in the same way as they are in the current RAM.)

For each post-test year, the approved test-year plant additions (net of CIAC) would be escalated using the appropriate construction cost escalator factors. The total 3-year net baseline plant additions would establish the net baseline plant additions cap for the rate case period. The net baseline plant additions for the test year would be used to determine the incremental capital related revenue requirement for the test-year to establish rates. The test year capital revenue requirement would be composed of the "existing net plant" (the year-end forecast of net plant preceding the test year) plus the incrementally approved net baseline plant additions. Similar calculations would be performed for the post-test years.

The Rate Base RAM relating to net baseline plan for each year would be established using these calculated revenue requirements. In the year after the 3-year rate case period, any rate adjustments necessary to true-up for actual baseline plant additions (up to the cap) would be implemented.

The Companies would track and manage actual baseline plant additions over the rate case period, against the cap. Following year 3, if the total actual baseline plant additions are equal to or less than the cap, the calculated revenue requirement for the actual plant additions would be compared to the revenue requirement collected in rates over the three years. Any difference would be trued-up in the next rate adjustment.

If the Companies exceed the cap, the revenue requirement for the plant in excess of the cap would be borne by the Companies until proposed for approval in the next rate case. For the next rate case, the "existing net plant" for year 2 plus forecasted actual new baseline

additions for year 3, would establish the "existing net plant" proposed for the next case. This would include any forecasted under or over-runs from the approved cap.

Note that under this alternative, the 5-year average baseline plant estimate would no longer be used in the calculation since annual targets of baseline plant estimates would be established in advance.¹⁰⁶

45. In its Reply SOP-B, the Consumer Advocate states that it reviewed both of the HECO Companies' alternatives and finds them "administratively complex, less effective at incenting cost controls tha[n] the existing RAM Rate Base mechanism, and conditioned upon acceptance of other terms that cause both alternatives to be harmful to ratepayers' interests."¹⁰⁷ The Consumer Advocate notes that both alternatives would require extensive advance commission review and approvals, and several additional concerns, including the following:

- What resources would be available to the Commission to critically review, on an expedited basis, the many baseline capital projects submitted by the HECO Companies to independently determine the "context and justification" for each project and the reasonableness of its budgeted cost.
- Why the HECO Companies would not be expected to seek to maximize future revenues and earnings by pessimistically overstating capital expenditure "needs"

¹⁰⁶HECO Initial SOP-B at 44-45.

¹⁰⁷CA Reply SOP-B at 61.

included in the annual presentations to the Commission.

- What administrative process would be used to present and reconcile differences of opinion regarding the relative value or justification for particular projects, or whether HECO Companies' management would ultimately decide spending levels if the Commission "input" could not be reconciled with utility financial plans and funding priorities.
- How involvement of the Commission in review and pre-approval of baseline capital spending would serve to increase cost-control incentives to utility management and not simply shift responsibility for cost control toward the Commission and its Staff.
- Whether the HECO Companies' management would retain the responsibility to optimize overall capital spending to achieve reliability targets, or that responsibility would be "shared" with the Commission due to its involvement in review of spending plans and budgets.
- What role the Consumer Advocate would need to play in the review and evaluation of the baseline capital projects.
- How the added resource and cost responsibilities imposed on the Commission and the Consumer Advocate would be met.

After Commission review and the establishment of capital spending targets, a series of complex calculations are then proposed under an Option A and an Option B that are described and illustrated in narratives that consume

pages 14 through 21 of Exhibit C to the HECO Companies' Initial SOP.¹⁰⁸

46. The commission shares the concerns expressed by the Consumer Advocate regarding the two alternatives proposed by the HECO Companies. The commission concludes that the both alternatives incorporate a process that (a) is overly complex, requires pre-approval of capital expenditure budgets without realistic and adequate procedures for examination and review; (b) shifts excessive responsibility to the commission; and/or (c) provides opportunities for the Companies to maximize revenues by gaming budget forecasts versus realized expenditures. As discussed below, the commission does utilize some elements of the Companies' alternatives in its amendments to the RAM specified in this Orders.

47. Several of the PBR framework proposals address the commission's concerns regarding cost control incentives by replacing the RAM (as well as other current rate making procedures) with an entirely new ratemaking framework. As discussed in Section V.A. above, the commission has concluded that a PBR framework will not be implemented at this time.

¹⁰⁸CA Reply SOP-B at 61-62.

Options To Address RAM Baseline Expenditures
Identified In The Commission's Post-Hearing Information Requests

48. Following the Schedule B evidentiary hearing the commission issued several information requests to the parties.¹⁰⁹ The responses to these requests are discussed below.

49. PUC-IR-1 asked parties to identify PIMs that would provide incentives to the Companies to control costs or minimize rates directly indexed on cost or rates. After examining the parties' responses and based on its review of the entire record, the commission concludes that no such "standalone" PIMs have been identified that could serve as effective amendments to the RAM to address the issue of baseline expenditures.¹¹⁰

50. PUC-IR-4 requested that the parties address a list of six possible options "to address concerns that the tariff currently allows all utility baseline expenditures to automatically be incorporated into effective rate base in the year following expenditure." The options identified by the commission in the information request are discussed below.

¹⁰⁹Order No. 32501, filed December 9, 2014.

¹¹⁰The commission notes that the Consumer Advocate proposed two PIMs in the context of its PBR proposal that are listed under the category of "Customer Costs", titled "Strategic Planning and Management" and "Results of Customer Surveys". See CA Initial SOP-B at 21. The commission does not find either of these PIMs to be indexed on or directly targeted at cost control.

51. The first option, identified in PUC-IR-4(a), would establish a cap on the baseline capital additions used in determining the Rate Base RAM:

a. Cap on baseline capital additions included in Ratebase RAM Adjustment: The baseline capital plant additions included in the determination of the Ratebase RAM Adjustment would be capped at the cumulative sum of annual baseline capital plant additions currently used to determine RAM period effective ratebase (based on the five-year moving average of historical baseline additions) without annual "true up" of recorded net plant in determining RAM period beginning-of-year net plant. If the Ratebase RAM Adjustment calculated according to existing provisions is less than this cap, baseline capital additions and the Ratebase RAM Adjustment would be calculated according to existing provisions, including true up of recorded net plant to determine beginning-of-year net plant for the RAM period.

52. In their response to PUC-IR-4(a), the HECO Companies note that this cap would probably result in RAM Revenue Adjustments smaller than the adjustment allowed under the existing provisions, which include a 90% limit on effective first year incremental Rate Base RAM calculations.¹¹¹ The Companies state that the existing five-year moving average, even with the annual "true-up" is conservative. Moreover, the Companies state that (a) eliminating the annual true-up would result in increased

¹¹¹HECO Response to PUC-IR-4 at 7.

understatement of 2015 and 2016 RAM under several scenarios; and (b) excluding the true-up for the actual 2014 net plant additions would "retroactively penalize the Companies for adding plant at the 2014 plant additions level, when they had no opportunity to adjust 2014 spending to take into account the new RAM method."¹¹²

53. The Companies suggest several alternatives to the cap as proposed in the information request. First, a three-year moving average of baseline plant additions could be used. Second, a cap could be implemented without annual true-up with baseline additions set at the test year level approved in the Companies' next rate cases, escalated annually by a construction cost indicator. Third, a cap could be set by the commission annually based on presentations by the companies on baseline capital expenditures.

54. In their response to PUC-IR-4(a), the HECO Companies also propose an exception provision for new baseline capital project categories.¹¹³ This provision is discussed in more

¹¹²HECO Response to PUC-IR-4 at 7-8. The commission observes here that the suggestion that the Companies would not have added plant at the 2014 levels without assumed assurance of automatic cost recovery provokes a question of whether the plant additions are, in fact, necessary for utility purposes (and would need to be implemented in any case) or whether they are discretionary additions encouraged by the provisions for automatic recovery through the true-up provisions of the existing Rate Base RAM and implemented with less-than-frugal consideration.

¹¹³HECO Response to PUC-IR-4 at 9-10. As discussed below, the commission incorporates the Exception Provision proposed by

detail below and is incorporated in the amendments to the RAM required pursuant to this Order.

55. In its response to PUC-IR-4(a), the Consumer Advocate notes that the imposition of a cap that would reduce baseline additions from the recorded baseline additions now used in the annual true-up would have derivative impacts upon recoverable annual depreciation and amortization expenses, and the accumulated depreciation, CIAC, and ADIT balances used in determining RAM period rate base in the Rate Base RAM.¹¹⁴ The Consumer Advocate also observes that because the baseline additions would be based on a moving average, the baseline projects would eventually be fully incorporated into the Rate Base RAM adjustments.

56. The commission concurs with the Consumer Advocate's observation that the PUC-IR-4(a) option would add considerable complexity to the determination of depreciation and amortization expense and the determination of depreciation, CIAC, and ADIT balances used in the calculation of rate base in the Rate Base RAM.

the HECO Companies, in most part, in the amendments to the RAM required in this Order.

¹¹⁴CA Response to PUC-IR-4(a) at 21.

57. The second option, identified by the commission in PUC-IR-4(b), is a variation of the first, using a shorter averaging period for historical baseline expenditures:

b. Same as "a." above except utilizing test year baseline expenditures or a less-than-five-year moving average as the annual basis used in determining the cap on applicable baseline capital additions.

58. The HECO Companies' response regarding this option is essentially similar to its response to option PUC-IR-4(a). The Consumer Advocate's response observes that using a three year moving average will result in revenues more favorable to the Companies but that eventually, as with the longer averaging period, all baseline expenditures would be incorporated into the Rate Base RAM adjustments.

59. The third option, identified in PUC-IR-4(c), is a cap on all annual RAM Revenue Adjustment increases:

c. Cap on annual RAM Adjustment increases: The annual increase in the RAM Adjustment (including O&M RAM Adjustment, Rate Base RAM Adjustment and Depreciation & Amortization RAM Adjustment) would be capped at a fixed percentage of the target revenues from the most recent rate case test year (or another suggested metric).

60. The HECO Companies' response to PUC-IR-4(c) notes that this option has similarities to the Companies' proposed

alternatives in response to PUC-IR-4(a).¹¹⁵ However, the Companies state that further work would be required to amend tariff provisions and detailed decoupling templates,¹¹⁶ and that there would be disadvantages in accommodating large, non-linear increases and decreases in revenues for "Major Projects."¹¹⁷

61. The HECO Companies further assert that a cap should only apply to baseline plant additions and should exclude the O&M RAM, Depreciation and Amortization RAM, Major Capital Projects, and new baseline capital projects.¹¹⁸ The Companies also state that there should be an exception provision ("Exception Provision") for new baseline capital project categories to allow certain baseline projects to be grouped for review as Major Capital Projects.¹¹⁹ In addition, the Companies state that a cap would need to provide for growth in new baseline

¹¹⁵HECO Response to PUC-IR-4(c) at 14.

¹¹⁶HECO Response to PUC-IR-4(c) at 14.

¹¹⁷HECO Response to PUC-IR-4(c) at 15. The commission notes that in the RAM tariffs, Major Capital Projects are defined as "those capital investment projects that require an application before and approval by the Commission under the Commission's General Order No. 7, but excluding those projects included in the Clean Energy Infrastructure Surcharge." In this Order, the term "Major Projects" refers to all projects subject to review and approval under the commissions General Order No. 7.

¹¹⁸HECO Response to PUC-IR-4(c) at 15-16.

¹¹⁹HECO Response to PUC-IR-4(c) at 16.

project additions required to implement the Companies' pending plans currently under review by the Commission:

[A]ny cap directed at net baseline plant additions should be high enough to allow for some growth in net baseline project plant additions due to the new projects that will be required to implement the Companies' PSIPs and DGIP which are approved or found to be reasonable by the Commission[^] (including projects necessary to implement cost-saving initiatives such as a switch to LNG), and normal inflation in construction costs. The magnitude of this allowance depends on whether there is an Exception Provision for New Baseline Capital Project Categories, and the scope of such an exception.

. . . .

If the cap is not set high enough, there is a risk that beneficial projects may be discouraged.¹²⁰

62. Finally, the Companies state that a cap would have to be substantially higher if there is not a workable Exception Provision for new baseline capital project categories.¹²¹

63. In its response regarding PUC-IR-4(c), the Consumer Advocate states that "[t]he practical effect of this alternative could be very similar to the RAM results achieved through application of the GDPPI based revenue cap proposed in the

¹²⁰HECO Response to PUC-IR-4(c) at 16-17 (footnotes omitted).

¹²¹HECO Response to PUC-IR-4(c) at 18.

Consumer Advocate's Initial SOP and Reply SOP submissions in this docket."¹²²

64. The Consumer Advocate also observes that, prior to setting any index higher than GDPPI for incrementing a cap on RAM adjustments, it may be appropriate to first resolve major planning issues being considered in other dockets that would impact future capital expenditure levels.¹²³ The Consumer Advocate suggests that application of a cap should be based on a cumulative application of percentage indexing to discourage non-optimal shifting of expenditures from year to year as might result from discrete annual increments. "Year by year application of a fixed percentage cap may serve to discourage otherwise prudent shifting of capital spending between years, so as to smooth incurred costs to avoid annually applied cap limitations."¹²⁴

65. The fourth option, identified by the commission in PUC-IR-4(d), is a variation of option (c) with an exclusion for Major Capital Projects:

d. Same as "c." above except excluding the impact of Major Capital Projects from the determination of the cap on annual RAM Adjustments increases and allowing separate explicit recovery for target revenue impacts of Major Capital Projects.

¹²²CA Response to PUC-IR-4(c) at 23.

¹²³CA Response to PUC-IR-4(c) at 24.

¹²⁴CA Response to PUC-IR-4(c) at 24.

66. The HECO Companies response regarding option (d) is essentially similar to the Companies' response regarding option (c).¹²⁵

67. With respect to the fourth option, the Consumer Advocate notes that it has concerns similar to those previously identified with respect to the first option. Thus, the Consumer Advocate states there are complications resulting from the need to segregate the impacts of baseline additions and Major Capital Project additions each year, including complexities of segregating the derivative effects on depreciation and amortization expense and the depreciation, CIAC, and ADIT balances used in determining the rate base in the Rate Base RAM.¹²⁶ The Consumer Advocate further states a preference for accommodating the need for desirable Major Capital Projects by expanded utilization of the REIP mechanism rather than otherwise separating Major Capital Projects from the cap contemplated in the fourth option.¹²⁷

68. The fifth option, identified by the commission in PUC-IR-4(e), considers using the Consumer Advocate's PBR provisions as an amendment to the RAM:

¹²⁵CA Response to PUC-IR-4(c) at 24.

¹²⁶CA Response to PUC-IR-4(c) at 25.

¹²⁷CA Response to PUC-IR-4(c) at 25-26.

e. The Consumer Advocate proposed PBR mechanism including the proposed performance incentive mechanisms. Discuss whether an index other than the GDPPI would be feasible and appropriate.

69. In their response to PUC-IR-4(e), the HECO Companies observe that the Consumer Advocate's proposal to modify the RAM includes provisions to (a) eliminate the Earnings Sharing Revenue Credits section of the RAM tariff; (b) utilize expanded application of the REIP mechanism for recovery of revenues for specific programs and projects; and (3) extend the rate case intervals to a five year cycle with a one-time adjustment of revenues to simulate the effects of a rate case.¹²⁸ The Companies assert that this option fails to provide for a fair rate of return and does not provide a workable mechanism for supporting necessary capital additions.¹²⁹ The Companies state that a construction capital cost escalator or an additional "capital factor" should be used rather than the GDPPI.¹³⁰

70. The Consumer Advocate's response to PUC-IR-4(e) focuses on the need to use GDPPI as an index rather than other alternatives.

No index other than GDPPI is appropriate. The U.S. Bureau of Economic Analysis ("BEA") published "Glossary: National Income and

¹²⁸HECO Response to PUC-IR-4(e) at 21.

¹²⁹HECO Response to PUC-IR-4(e) at 21-22.

¹³⁰HECO Response to PUC-IR-4(e) at 22.

Production Accounts defines GDPPI as an index, "...that measures the prices of final goods and services produced by the U.S. economy. It is derived from the prices of personal consumption expenditures, gross private domestic investment, net exports, and government consumption expenditures and gross investment."

The Consumer Advocate believes that the most appropriate index for use within a simplified RAM is one that recognizes that costs incurred by utilities are subject to unavoidable general inflation and that some accounting for general inflationary pressures upon the revenue requirement is appropriate within the RAM between rate cases. The GDPPI revenue cap approach recommended by the Consumer Advocate was selected because it:

- Is a broad based indicator of price level changes across the entire U. S. Economy;
- Uses data compiled by the federal government without dependence upon proprietary models or services;
- Is published monthly and is widely available in the public domain;
- Includes both business investment and personal consumption transactions and weightings; and
- Is not dependent upon third party vendors and proprietary studies and methods that lack transparency and the ability to verify results.

Consideration was given to use the more narrowly defined and widely used Consumer Price Index, but that index was rejected because it is heavily weighted with food, housing and other personal consumption

expenditures that are not representative of utility input resources.¹³¹

71. The sixth option, identified in PUC-IR-4(f), is similar to option (e) except that Major Capital Projects would be treated separately:

f. Same as "e." above except maintaining the current method of determining the Major Capital Projects component of the Ratebase RAM and the Depreciation and Amortization RAM Adjustment (i.e., indexing the test year O&M and baseline plant addition components of revenue requirements by GDPPI). Discuss whether an index other than the GDPPI would be feasible and appropriate. Discuss whether the Consumer Advocate's proposed performance mechanisms would be necessary with this approach in order to ensure utility performance in conjunction with limits on baseline capital project cost recovery between rate cases.

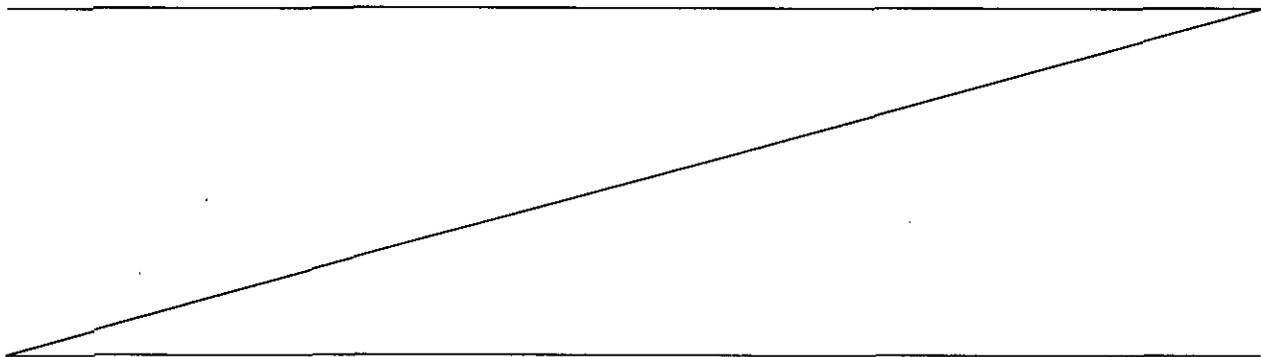
72. The HECO Companies' response to PUC-IR-4(f) repeats their concerns with the fifth option regarding the use of the Consumer Advocate's proposed PBR mechanism as an amendment to the RAM to provide cost control incentives. The Companies cite their previous testimony describing the function and purpose of performance mechanisms in the context of PBR frameworks and identify concerns regarding specific performance mechanisms proposed by the Consumer Advocate.¹³² The Companies also

¹³¹CA Response to PUC-IR-4(e) at 26-27 (footnote omitted).

¹³²HECO Response to PUC-IR-4(f) at 27-28.

state their opposition to the Consumer Advocate's proposed "planning PIM," but state that "this does not mean that the Companies are opposed to a well-designed PIM aimed at incentivizing effective and efficient planning."¹³³

73. The Consumer Advocate states that the sixth option would be subject to the same cautions identified with respect to the first option regarding increased complexity due to the need to separate baseline projects from Major Capital Projects in calculating RAM adjustments. The Consumer Advocate notes that separate treatment of Major Capital Projects would reduce dependence upon the Consumer Advocate's recommendation for expanded use of the REIP mechanism for cost recovery for desirable capital projects with prior commission review.



¹³³HECO Response to PUC-IR-4(f) at 27-28.

c.

Commission's Amendments To The RAM

(1)

Intent And Purpose For Changes To The RAM

74. The commission reiterates its previous findings that the continued application of the current Rate Base RAM tariffs does not result in rates that are just and reasonable.¹³⁴ For the reasons discussed herein, the commission concludes that changes to the RAM are necessary.

75. The intent and purpose of the commission's amendments to the RAM are to: (a) maintain the current functions of the RAM to provide timely recovery of appropriate revenues between general rate cases; (b) ensure that sizeable capital expenditures are examined by timely review prior to automatic inclusion in effective rates through the RAM; (c) avoid adding further complexity to the decoupling mechanisms; and (d) fundamentally ensure that the RAM results in rates that are just and reasonable.

76. The amendments to the RAM are not designed to limit the Companies' recovery of necessary and reasonable revenue requirements. Nor is it the intent of the amendments to shift or reallocate any costs or risks associated with the incumbent

¹³⁴Order No. 31908 at 48, Issue #2, Finding (9.).

decoupling mechanisms or ratemaking process between the Companies and ratepayers.

77. As clarified in detail below, the commission is amending the RAM by limiting the amount of automatic annual RAM Revenue Adjustment increases. The RAM is being amended on an interim basis pending the outcome of the commission's review of the HECO Companies' PSIPs in Docket No. 2014-0183. As discussed throughout this Order, one major purpose for this amendment is to limit the amount of unapproved capital project net plant additions that can automatically be incorporated into effective rates through the RAM. The HECO Companies may still recover certain revenue requirements above what is allowed for automatic revenue adjustment for additional capital projects through the RAM, REIP, or other mechanisms, by obtaining prior approval from the Commission on a case by case basis. However, in lieu of well-vetted, approved resource or improvement plans, the Companies must demonstrate that eligible capital projects and expenditures are prudent and reasonable, will provide customer value, and will not adversely affect the affordability of energy services. The amount of automatic RAM recovery allowed on an ongoing basis (without prior review of sizeable capital projects) is based on the most recent approved target revenues, incremented annually up to a cap equal to the rate of general inflation.

78. With respect to recovery of revenues for capital projects, the amended RAM will thus allow continued automatic revenue recovery for capital project net plant additions in an amount effectively in rough approximation to the rate of depreciation and amortization on approved utility rate base, plus an increment of effective rate base indexed on general inflation. Beyond that, the amended RAM is intended to allow recovery of revenues for additional capital projects with prior approval by the commission.

79. The amendments to the RAM are being implemented on an interim basis pending resolution of the currently ongoing review of the HECO Companies' PSIPs. The amendments to the RAM implemented by this Order replace and terminate the previous interim limitations on RAM year Rate Base RAM adjustments required pursuant to Order No. 31908.

Amendments To The RAM

80. In determining appropriate amendments to the RAM, the commission considered all of the options identified by the parties in both the Schedule A and Schedule B phases of this proceeding, as well as the options identified by the commission in PUC-IR-4.

81. As noted above, the commission does not agree that it is appropriate to implement any of the options identified by the HECO Companies that would provide quasi- or pre-approval of future capital investments that would require and rely on forward-looking or multi-year projections of capital expenditure budgets, either in the context of a general rate case or in the context of annual budget briefings to the commission.

82. As also noted above, the commission will not implement a PBR framework at this time, and has not identified any stand-alone cost control PIMs that would suffice to address the commission's concerns regarding cost control incentives and baseline project provisions in the RAM.

83. In its post-hearing information requests to the parties, the commission identified six options for consideration by the parties. The responses by the parties are briefly recounted above. The commission rejected the options identified in PUC-IR-4 parts (a), (b), (d) and (f) due, at least

in part, to the increased complexities identified by the Consumer Advocate and the possibility of decreased accountability that would result from segregating the accounting for baseline projects and Major Capital Projects regarding depreciation and amortization expense and balances for accumulated depreciation, CIAC, and ADIT in the filing and review of the annual decoupling submittals.

84. In determining an appropriate amendment to the RAM, the commission focused on the general approaches in options (c) and (e). The option (c) approach would establish a cap on RAM adjustments based on an escalating index. If calculated RAM adjustments would fall under the cap, allowed revenues would be less than the cap. The approach in option (e) would determine allowed revenues according to an escalating index, allowing the Companies to potentially profit from realized economies and cost reductions if realized costs were less than determined revenues. This would provide an incentive for cost control consistent with the intended principles of PBR.

85. At this time, the Commission prefers the option (c) approach as a central mechanism for a RAM amendment. The purpose of the RAM is primarily to serve as a mechanism to provide reasonable revenues between scheduled general rate cases. The commission is not now inclined to allow or rely on substantial

profit opportunities in the RAM to function as the basis for incentives to the Companies to control costs.

86. Both the HECO Companies and the Consumer Advocate observe that a cap approach has similarities with alternatives they have identified or advocated. The Companies note similarities to Alternative 2 as proposed in their Initial SOP-B.¹³⁵ The Consumer Advocate notes similarities to its GDPPI based revenue cap approach.

87. The practical effect of utilizing the option (c) approach may be very similar to the RAM results achieved through application of the GDPPI based revenue cap proposed in the Consumer Advocate's Initial SOP and Reply SOP submissions in this docket. At the present time, non-labor O&M expenses that are not recoverable or tracked through another tracking mechanism (e.g., fuel, purchased power, pension, OPEBs) are already escalated using a GDPPI factor. This same GDPPI factor could be used to ensure that Rate Base RAM; and Depreciation & Amortization RAM increases do not exceed general inflation levels.¹³⁶

88. The commission is mindful of cautions expressed by the parties regarding the possible consequence of implementing

¹³⁵HECO Response to PUC-IR-4(c) at 14.

¹³⁶CA Response to PUC-IR-4(c) at 23-24.

caps or limits on RAM revenue recovery generally and/or using external price indices to determine caps or limitations. These cautions are addressed below.

89. First, as acknowledged by several parties, limiting revenue can provide incentives to reduce costs by sacrificing service quality. As concisely summarized by the Consumer Advocate:

RAM modifications that substitute external price indices or impose limitations on price changes over multiple RAM years (with no rate case opportunity as a regulatory backstop) could incent the HECO Companies to reduce costs in order to maximize earnings. Aggressive cost controls stimulated by such changes, on the other hand, may inadvertently jeopardize service quality and/or the utility's willingness and ability to support renewables deployment and other strategic Initiatives. The specific design of any RAM modifications using external drivers or limitations would need to consider and carefully balance ratepayers' interests in safe and reliable service, as well as clean energy initiatives, all at just and reasonable rates in both the short and longer term.¹³⁷

90. To address this issue, as provided below, the commission is requiring the parties to provide briefs and reply briefs regarding the implementation of the "conventional" PIMs proposed by the Consumer Advocate in its PBR framework and related PIMs proposed by other parties.

¹³⁷CA Final SOP-B at 21.

91. Second, the commission recognizes the HECO Companies' need to finance necessary capital investments. Without making specific findings regarding the quantitative analyses presented by the parties, the commission shares the concerns stated in principle by the HECO Companies,¹³⁸ and acknowledged by the Consumer Advocate,¹³⁹ regarding limiting incremental revenues by an index for inflation without providing sufficient additional timely recovery for necessary capital projects. To address this issue, the Consumer Advocate recommends expanded use of the REIP mechanism as a means for the Companies to recover revenues for capital projects above and in addition to revenues escalated by an index of inflation.¹⁴⁰

92. The commission concludes that use of the REIP alone, even expanded use as suggested by the Consumer Advocate,

¹³⁸The HECO Companies present several quantitative analyses to demonstrate the insufficiency of revenue recovery under various scenarios and assumptions, and provide several conclusions throughout their filings to the effect that "increasing the revenue requirement by inflation alone is unlikely to provide the Companies with sufficient revenue to invest as needed to meet Hawaii's goals while also providing the Companies a fair opportunity to earn their cost of capital." HECO Reply SOP-B at 79.

¹³⁹The Consumer Advocate presents quantitative analysis examining revenue sufficiency for its proposed PBR mechanism based on incrementing allowed revenues by a GDPPI index. The Consumer Advocate acknowledges the need for cost recovery in addition to escalation for inflation and accordingly recommends expanded utilization of the REIP mechanism. CA Initial SOP-B at 48.

¹⁴⁰See CA Initial SOP-B at 48.

would not provide sufficient or appropriate means for recovering revenues for necessary projects that fall outside the scope of the REIP mechanism. The REIP mechanism is generally limited to providing recovery of costs for renewable energy infrastructure. By this Order, the commission does intend to limit the amount of automatic recovery through the RAM for projects that do not have prior review or approval by the commission, but the commission does not otherwise intend to limit the scope of types of projects that may qualify for application for cost recovery prior to a general rate case.

93. To address this issue, the commission turns to the Companies' proposal for an Exceptions Provision, which would allow the Companies to group related baseline projects as Major Capital Projects for purposes of review by the commission:

[T]he Companies propose an exception provision to treat certain categories of baseline capital programs or projects similar to major capital projects (i.e., "G.O. 7 projects") for review, approval and RAM cost recovery purposes, and therefore receive recovery outside of the revenue cap. Under the exception provision, the Companies would file an application, pursuant to Rule 2.3.g.2 of General Order No. 7, to commit capital expenditures in excess of \$2.5 million for certain groups or categories of baseline capital projects. The groups or categories would consist of new types of baseline projects or projects or programs identified and triggered by the Companies' PSIPs, DGIP, IDRPP or other transformational plans filed with the Commission. The groups or categories of baseline capital projects that

receive Commission approval of the associated G.O.7 application would be treated as major capital projects under the RAM tariff and would be reflected in the rate base RAM - return on investment and depreciation and amortization RAM expense revenue adjustments for major capital projects. This would ensure that these groups and categories of baseline projects, that receive recovery outside of the baseline revenue cap in the years between rate cases, would be subject to prior Commission review and approval.¹⁴¹

94. As specified below, the commission incorporates the principal features of the proposed Exceptions Provision in its amendments to the RAM in this Order.¹⁴²

95. More expansively, the commission provides that, in conjunction with a RAM Cap indexed on the GDPPI, the Companies may apply to the commission for recovery of necessary and reasonable revenue requirements for any type of Major Project (including related baseline projects considered on a programmatic basis as Major Projects), to be implemented through the RAM, REIP, or other proposed mechanism if found to be reasonable and prudent.

¹⁴¹HECO Response to PUC-IR-4 at 9-10.

¹⁴²One difference in the commission's use of this provision is its application to a cap on overall RAM Revenue Adjustments, whereas the Companies' proposal was made regarding an option to cap only baseline additions. The commission also applies the provision more broadly than suggested by the Companies and does not limit its application to projects or programs identified in or triggered by specified plans or to transformational projects.

96. The commission concludes that the GDPPI is an appropriate index to use in the determination of the RAM Cap. The commission's intent is to use the index as a measure of general inflation. As noted above, the commission concurs with the arguments presented by the Consumer Advocate in support of the GDPPI as an appropriate and preferred index in its response to PUC-IR-4(e). The commission prefers an indicator that is available in the public domain, such as the GDPPI. The commission further observes that the GDPPI is already used as the index for non-labor expenses in the O&M RAM.

97. The commission also agrees with the Consumer Advocate's preference to apply the index on a cumulative basis in order to avoid incentives that might encourage non-optimal year-by-year investment timing.¹⁴³

98. The commission directs the HECO Companies to apply the RAM Cap starting with the determination of the 2015 RAM Revenue Adjustments. For the initial implementation of the RAM Cap and until the next general rate case for each company, the starting basis for determining the RAM Cap will be the 2014 target revenues adjusted upward to include the actual recorded end-of-year statements of net plant in service, depreciation and

¹⁴³CA Response to PUC-IR-4(c) at 24.

amortization, CIAC, and ADIT as the end-of-year rate base for the calculation of the 2014 RAM Revenue Adjustment.

(3)

Risk And Return

99. As noted above, it is not the intent or purpose of the amendments to the RAM to change, shift, or reallocate risk between the HECO Companies and ratepayers. Nevertheless, the commission considered the extent to which, despite any deliberate intent, the amendments may affect the magnitude or allocation of risk as compared to the currently-existing RAM mechanism.

100. The parties provided extended discussions regarding the risk and cost of capital associated with the decoupling mechanisms and the appropriateness of corollary adjustments to the Companies' ROE.¹⁴⁴ The parties variously discuss and present analysis, and reach diverse conclusions concerning the risk, costs, and the allocation of risks and costs, associated with the original implementation of the RBA and RAM and

¹⁴⁴See HECO Companies Initial SOP-B at 22-27 and Exhibits D and E; HECO Companies Reply SOP-B at 39-42; HECO Companies Reply SOP-B Exhibit A at 16-17; HECO Reply SOP-B Exhibit B at 24-32; HECO Companies Reply SOP-B Exhibits D, G and H; CA Initial SOP-B at 48-50 and Exhibit C; CA Reply SOP-B at 51-54 and Exhibit A; COH Initial SOP-B at 16-19; COH Reply SOP-B at 11-18 and 31-32.

possible scenarios of termination or substantial amendment of the RBA and/or RAM.

101. With respect to the particular amendments to the RAM made in this Order, the commission finds that no adjustment to ROE is warranted. The amendments to the RAM ordered by the commission do not ultimately diminish the HECO Companies' recovery of necessary and reasonable revenue requirements. The amended RAM will continue to serve its intended purposes, albeit with requirements and provisions for appropriate prior review procedures for recovery for sizeable capital expenditures through the RAM, REIP, or other adjustment mechanisms. Automatic expanded recovery of ordinary revenues through the RAM will continue.

102. The HECO Companies' position is that amendments to the RAM that might change the timing of revenue recovery but not the ultimate recovery of revenues would not change the Companies' cost of capital. As asserted by the HECO Companies:

The Brattle Group then responded to the question of if the RBA were left in place, but the RAM were to be substantially modified, what would be the likely effect on the cost of capital? "The answer, of course, depends upon how the RAM were modified and what, if any, policy were to replace it. The RAM primarily serves to recover changes in costs between rate cases. Unless the risk of cost recovery as opposed to the timing of cost recovery were to increase without the RAM,

the cost of capital is unlikely to be substantially affected."¹⁴⁵

103. The commission concludes that the amendments to the RAM in this Order will not diminish the Companies' ability to ultimately recover just and reasonable revenues for necessary capital projects.¹⁴⁶

104. The commission further concludes that amending the adjustments to ROE associated with the decoupling and other adjustment mechanisms that were determined in the previous rate cases of each of the HECO Companies is not appropriate.

(4)

Detailed Description Of The Required RAM Amendments

105. The RAM will be amended by implementing a limit or cap on cumulative, automatic annual RAM Revenue Adjustments.¹⁴⁷ The amendment will be applied on an interim basis pending the

¹⁴⁵HECO Initial SOP-B at 25 and HECO Initial SOP-B Exhibit B at 28. The commission notes that the HECO Companies' witness Fetter reaches similar conclusions. HECO Initial SOP-B at 23 (referring to HECO Initial SOP-B Exhibit E).

¹⁴⁶The commission made similar findings in Order No. 31908 at 45-46.

¹⁴⁷The term "automatic" as used in this Order refers to adjustments in effective rates that (a) occur outside of and generally between general rate case proceedings; (b) are implemented by an "automatic rate adjustment clause," as this term is used in HRS Chapter 269.16(b); and (c) do not require, in each instance, explicit prior approval by the commission.

outcome of the proceedings in Docket No. 2014-0183. At that time the Commission will determine any further actions regarding the RAM provisions.

106. The HECO Companies shall continue to file submittals in accordance with the existing RBA and RAM tariffs by March 31 of each year, except as amended in this Order. The RAM Revenue Adjustment to be applied to determine effective Target Revenues will be the lesser of (a) the RAM Revenue Adjustment determined according to existing tariffs and procedures or (b) a RAM Revenue Adjustment Cap ("RAM Cap") to be calculated as specified below.

107. The RAM Cap shall be based on the Target Revenues determined in accordance with the RBA and RAM tariffs as provided below ("Basis"), times the cumulative annually compounded increase(s) in GDPPI for intervening years, adjusted to include applicable revenue taxes.¹⁴⁸ The Basis used in determining the RAM Cap shall be adjusted to exclude or otherwise appropriately account for adjustments for the recovery of revenues for previously explicitly stipulated and approved exceptional matters or other

¹⁴⁸The statement regarding adjustment for revenue taxes here is intended to acknowledge current provisions, not to change the treatment of revenue taxes in the RBA and RAM tariffs. Target Revenues are defined and applied in the RBA tariff net of revenue taxes. The RAM Revenue Adjustment in the RAM tariff is stated and applied including applicable revenue taxes.

matters specifically ordered by the commission, which shall, in any event, be recovered fully without respect to any limitations resulting from application of the RAM Cap.¹⁴⁹

108. For each of the HECO Companies, for the calculation of the RAM Cap for the 2015 RAM Revenue Adjustment and until issuance of a final decision and order in the next rate case for each Company, the target revenues that will serve as the Basis for the incremented cap will be the 2014 annualized target revenues adjusted as follows. The 2014 RAM Revenue Adjustment used to determine the adjusted 2014 target revenues for purposes of determining the cap will be adjusted to use recorded 2014 end-of-year actuals (plant in service, depreciation and amortization, CIAC, and ADIT) rather than 2014 RAM year projections in determination of the 2014 Depreciation and Amortization RAM Expense and average rate base in the 2014 Rate Base RAM.¹⁵⁰ This provision will include in

¹⁴⁹The commission notes that currently such applicable matters include adjustments accounting for CT-1 costs (for the HECO Companies) and CIS costs (for all of the HECO Companies) as provided in a stipulated agreement approved by the commission as amended in Order No. 31126 in Docket No. 2008-0083.

¹⁵⁰The effective rate base for the adjusted 2014 Rate Base RAM calculations in determining the adjusted 2014 target revenues for purposes of calculating the initial RAM Cap would thus be as follows: the simple two point average of the beginning-of-year and end-of-year rate base determined, in both cases, by using recorded actual plant additions and depreciation/amortization, CIAC, and ADIT balances, adjusted as noted above to appropriately

the determination of the average 2014 effective rate base used in determining the RAM Cap for the 2015 RAM Revenue Adjustment, the actual end-of-year net plant in service, including all baseline projects installed in 2014, rather than the five year moving average of baseline project expenditures used in the determination of the 2014 Rate Base RAM. The adjusted 2014 target revenues will be incremented by the GDPPI index to determine the RAM Cap as provided above.

109. Following the issuance of a final decision and order in a rate case, the Basis for the calculation of the RAM Cap shall be the target revenues determined in accordance with the RBA tariff based on the results of the Company's most recent final rate case decision.

110. The RAM Cap will apply to the entire RAM Revenue Adjustment including the O&M RAM, Rate Base RAM (including Major Capital Projects and Baseline Projects), and the Depreciation and Amortization RAM.

111. The RAM shall continue to function as a means for target revenues to increase between rate cases in order to provide reasonable revenues to the utilities. The amendments to the RAM will not, in any respect, limit or dilute the ordinary

account for adjustments for stipulated matters approved by the commission.

opportunities for each utility to seek rate relief according to conventional/traditional ratemaking procedures.

112. In the Decoupling Order, the commission established a Mandatory Triennial Rate Case Cycle "[s]o 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..."¹⁵¹ The Mandatory Triennial Rate Case Cycle shall continue to serve as a maximum period between the filings of general rate cases for each of the Companies unless otherwise ordered by the commission.

113. The Companies may apply to the Commission for approval of recovery of revenues for Major Projects through the RAM above the RAM cap or outside of the RAM through the REIP or other adjustment mechanism.¹⁵² Approval for such recovery will be made on a case by case basis. Any such application shall identify and support the specific means and extent of proposed cost recovery.

114. Eligibility for recovery above the RAM cap or by adjustment mechanism outside of the RAM will be restricted to

¹⁵¹Decoupling Order at 73 and 129.

¹⁵²"Major Projects" are defined in footnote 117, supra.

revenues for projects that HECO, MECO, or HELCO demonstrate to be prudent and reasonable, to provide customer value, to enhance the affordability of energy services, and which are not explicitly or implicitly included in otherwise effective utility target revenues or other effective means of revenue recovery.

115. The Companies may use a programmatic approach to categorizing and consolidating related baseline projects for consideration as Major Projects. For example, multiple baseline projects that serve a related purpose or are part of a specific program may be consolidated as a Major Project for purposes of application and review.

116. The Companies and Consumer Advocate shall develop standards and guidelines for eligibility of projects and determination of the amount of eligible cost recovery above the RAM Cap or outside of the RAM mechanism through the REIP or other adjustment mechanism and present these to the Commission for approval. With respect to this issue, the commission notes that the HECO Companies and the Consumer Advocate have submitted draft standards and guidelines regarding eligibility for projects for the REIP mechanism in Docket No. 2010-0139. To the extent relevant, those standards and guidelines may be included and revised in response to this directive.

C.

Changes To General Rate Case Filing
And Review Procedures

As set forth in Order No. 31635, Schedule B

Specific Issue #8 addresses the following general issue:

8. What changes could be made to existing general rate case filing and review procedures to improve the efficiency and effectiveness of regulatory oversight?

The specific sub-issues for Issue #8 are set forth in Appendix A to this Order.

1.

Positions Of The Parties

The Consumer Advocate identifies a list of changes that could be made to general rate case processes "that could produce significant efficiencies while also improving the effectiveness of regulatory oversight."¹⁵³ The options, paraphrased briefly here, include:

1. Utilizing generic proceedings for issues of common relevance to all of the HECO Companies;
2. Limiting the filed evidence by excluding formally filing voluminous supporting workpapers unless required in evidence and use of electronic media;

¹⁵³CA Initial SOP-B at 70.

3. Limiting the filing of discovery responses unless needed in evidence;
4. Establishing minimum filing requirements to provide standardized schedules and data;
5. Modifying procedural schedules to facilitate administrative efficiency; and
6. Unbundling and removing fuel and purchased power cost recovery from base rates.¹⁵⁴

The Consumer Advocate recommends that these options could be the subject of workshops with the HECO Companies and commission staff with the goal of refining the options and developing joint recommendations.¹⁵⁵

The HECO Companies support streamlining and simplifying the rate case process¹⁵⁶ and propose several measures, including: (a) consolidating the individual Company rate cases into one rate case for all three Companies;¹⁵⁷ (b) consolidating certain issues between individual Company rate cases before entering a consolidated rate case for all Companies;¹⁵⁸ and (c) using rate case memorandum accounts to reduce regulatory

¹⁵⁴CA Initial SOP-B at 70-74.

¹⁵⁵CA Initial SOP-B at 74-75.

¹⁵⁶HECO Initial SOP-B at 54.

¹⁵⁷HECO Initial SOP-B at 54-56.

¹⁵⁸HECO Initial SOP-B at 56-57.

lag by allowing retroactive adjustment of rates to the beginning of the test year.¹⁵⁹ The Companies also support efforts to "standardize rate case filings and modify the rate case review process to resemble the annual RBA and RAM filings and review process."¹⁶⁰ The Companies state that they are willing to work with and will seek the recommendations of the Consumer Advocate and its consultants to streamline and simplify the rate case process.¹⁶¹

The Consumer Advocate states that the commission should treat a movement to "postage stamp" rates as a major policy issue that should be thoroughly vetted and notes several characteristics of existing rate differentials, subsidies and consolidation issues.¹⁶² The Consumer Advocate suggests that, as an initial moderate step, the commission could consider consolidating MECO's rates for the Maui, Lanai and Molokai systems.¹⁶³ The Consumer Advocate maintains that any administrative efficiencies from consolidating rate cases for the three HECO Companies would only be substantially realized if fully

¹⁵⁹HECO Initial SOP-B at 57-58.

¹⁶⁰HECO Initial SOP-B, Exhibit B at 57.

¹⁶¹HECO Initial SOP-B, Exhibit B at 57.

¹⁶²CA Initial SOP-B at 76-77.

¹⁶³CA Initial SOP-B at 76.

uniform rates are implemented.¹⁶⁴ The Consumer Advocate recommends that a regulatory proceeding limited to rate consolidation should be initiated to address these issues.¹⁶⁵

The Companies concur with the Consumer Advocate that movement toward uniform state-wide rates is a significant policy issue that can be considered in a separate proceeding dedicated to this purpose.¹⁶⁶ The Companies note that there are other approaches to address inter-utility equity that address compliance with Renewable Portfolio Standards.¹⁶⁷

The Consumer Advocate alleges that regulatory lag is not a problem for the HECO Companies because the Companies "currently enjoy a rich portfolio of regulatory mechanisms to track and fully recover the majority of their incurred costs."¹⁶⁸ The Consumer Advocate also notes, however, that there is a perception in the "financial community" that regulatory lag is a problem in Hawaii, and that this stems from the extended time between interim and final orders, even though the dollar amounts at issue between these orders are often not significant.

¹⁶⁴CA Initial SOP-B at 76.

¹⁶⁵CA Initial SOP-B at 77.

¹⁶⁶HECO Reply SOP-B. Exhibit M at 16.

¹⁶⁷HECO Reply SOP-B. Exhibit M at 16.

¹⁶⁸CA Initial SOP-B at 79.

The Consumer Advocate suggests that stakeholders should investigate how to facilitate reduction of "regulatory lag" issues to allay investment community concerns.¹⁶⁹

The HECO Companies propose utilization of rate case memorandum accounts, as noted above, to reduce regulatory lag.¹⁷⁰ The Companies also maintain that, with respect to several proposed alternatives, the adjustment to the HECO RAM that allows HECO to accrue later-adjusted revenues for the first five months of the RAM period should be made permanent and that similar treatment should be applied to MECO and HELCO.¹⁷¹

2.

Commission Findings And Conclusions

117. The commission generally finds value in measures that can improve the efficiency and effectiveness of utility regulation. The commission notes some similarities and some substantive differences in the proposals made by the HECO Companies and Consumer Advocate in this proceeding.

118. The commission does not decide on the implementation of any specific measures in this Order, nor does

¹⁶⁹CA Initial SOP-B, footnote 43 at 79.

¹⁷⁰HECO Initial SOP-B at 57.

¹⁷¹See, e.g., HECO Initial SOP-B at 46.

the commission now decide on the merits of moving towards uniform multi-utility or multi-island rates. In the briefs and reply briefs required by this Order, the parties shall address the following issue:

What are the appropriate steps, processes, and timing for determining measures to improve the efficiency and effectiveness of the general rate case filing and review process?

Among other things, responses to this issue shall address the Schedule B Specific Issue #8 cited above, including all four subparts.

D.

Changes To Annual Decoupling Filing
And Review Procedures

As set forth in Order No. 31635, Schedule B specific issue #9 is as follows:

9. Whether and how the implementation and annual review of the decoupling mechanisms can be simplified?

a. What changes to the decoupling mechanisms, filing procedures or review procedures could be made to improve the efficiency, transparency and/or accuracy of the implementation and annual review of the decoupling mechanisms?

Positions Of The Parties

The Consumer Advocate notes that significant steps have already been taken to simplify and improve the accuracy of annual decoupling filings and reviews, including development of standardized templates for the RBA and RAM calculations and filings.¹⁷² Nevertheless, the Consumer Advocate states that more can be done to simplify necessary calculations. In this regard, the Consumer Advocate identifies several aspects of remaining complexity including: (a) meticulous segregation of Recorded Adjusted Revenues complicated by separate accounting of monthly billed and unbilled revenues; (b) inclusion of part of fuel and purchased energy cost recovery in base rates; and (c) accounting for billing adjustments of specific customers.¹⁷³ The Consumer Advocate also notes that using a GDPPI index to determine RAM adjustments, as it recommends to address RAM cost control concerns, would simplify much of the annual filing and review process.¹⁷⁴

The HECO Companies disagree with several of the Consumer Advocate's observations regarding the segregation of

¹⁷²CA Initial SOP-B at 80.

¹⁷³CA Initial SOP-B at 80-81.

¹⁷⁴CA Initial SOP-B at 82-82.

billed and unbilled revenues, and the segregation of fuel and purchased energy costs from base rates. The Companies maintain that, among other concerns, changing the current practices would complicate rather than simplify the filing and review process.¹⁷⁵ The HECO Companies also oppose changing current practices regarding billing adjustments for certain customers from pre-decoupling periods.¹⁷⁶

The HECO Companies also again discuss their two proposed alternatives concerning the review of baseline expenditures in the RAM. As discussed above, these alternatives were proposed to address the commission's concerns regarding cost control incentives and the RAM provisions regarding baseline expenditures. Both alternatives include provisions for commission pre-approval of projections of baseline expenditures.

COH opposes the continuation of the RBA and RAM mechanisms but maintains that, if the mechanisms remain in place, the review process should include the use of an independent third-party auditor.¹⁷⁷ The HECO Companies argue that sufficient

¹⁷⁵HECO Reply SOP-B, Exhibit N at 1-5.

¹⁷⁶HECO Reply SOP-B, Exhibit N at 5-8.

¹⁷⁷COH Initial SOP-B at 27.

review procedures are already in place and that a third party auditor would be costly and unnecessary.¹⁷⁸

2.

Commission Findings And Conclusions

119. The commission acknowledges the efforts of the HECO Companies and Consumer Advocate in working to implement pre-vetted standardized templates to facilitate efficient and effective review of the annual decoupling filings. The commission encourages the Companies and Consumer Advocate to continue to cooperate and work towards further efficiencies. Parties shall bring to the commission's attention any matters that need resolution in order to provide accurate filings and effective review. The commission takes no further action on this matter at this time.

E.

Changes To The ECAC Mechanisms

The commission did not explicitly identify changes to the existing ECAC mechanisms for the HECO Companies as a specific issue to be addressed in this proceeding. Nevertheless, several parties proposed changes to the ECAC in

¹⁷⁸HECO Reply SOP-B, Exhibit N at 8.

addressing several of the identified issues, including incentives to control costs,¹⁷⁹ and allocation of risks and costs.¹⁸⁰

1.

Positions Of The Parties

Blue Planet proposed two options to modify the ECAC mechanism to "reflect risk-sharing between the utility and its customers" that would pass through only part of increases or decreases in fuel costs. One option would pass through limited proportions of fuel costs above a baseline level.¹⁸¹ The other option would pass through only increases or decreases that exceed a specified threshold.¹⁸² For both options, Blue Planet recommends elimination of the existing "heat rate adjustment" features of the ECAC.¹⁸³

Blue Planet recommends that the proportion of fuel cost changes borne by the HECO Companies could be increased incrementally each year until the Companies bear the entire risk

¹⁷⁹See Schedule B Specific Issue #2.

¹⁸⁰See Schedule B Specific Issue #4

¹⁸¹Blue Planet Reply SOP-B at 11.

¹⁸²Blue Planet Reply SOP-B at 11-12.

¹⁸³Blue Planet Reply SOP-B at 12.

of fuel cost changes.¹⁸⁴ Blue Planet alleges that changes in the ECAC would "give the utility 'skin in the game,'" and are necessary to comply with the provisions of HRS 269-16(g) regarding fairly sharing risk of fuel cost changes between a public utility and its customers, and providing sufficient incentive to a public utility to reasonably manage or lower fuel costs and encourage greater use of renewable energy.¹⁸⁵

HSEA proposes elimination of the "heat rate incentives" in the ECAC, and supports the options proposed by Blue Planet for either a "partial pass-through" or a "deadband" mechanism, and a "phase down of the ECAC pass-through incrementally over a long term period."¹⁸⁶

In the commission's information request PUC-IR-3; addressed to the parties following the evidentiary hearing, the commission asked:

Aside from proposals to provide limited or fractional energy cost adjustment (ECAC) recovery (such as those already in the record), are any mechanisms or amendments to the ECAC mechanism feasible to appropriately allocate fuel price risk and provide incentives to the utility to minimize power production costs? Describe how any such possible mechanisms or amendments would be

¹⁸⁴Blue Planet Reply SOP-B at 13.

¹⁸⁵Blue Planet Reply SOP-B at 11-12.

¹⁸⁶HSEA Initial SOP-B at 17-18.

implemented and identify pertinent advantages and disadvantages.¹⁸⁷

The Consumer Advocate responded by warning that "[a]ny amendments to the ECAC should be evaluated with great care to avoid unintended consequences."¹⁸⁸ The Consumer Advocate states that it is not aware of feasible ECAC revisions that could be implemented at this time.¹⁸⁹ The Consumer Advocate favors greater ECAC audit and regulatory review to "encourage cost control and to identify and deny recovery of any imprudently incurred energy costs through the ECAC mechanism."¹⁹⁰

The HECO Companies provided a substantial response to PUC-IR-3. The Companies state that improvements to the ECAC are possible to address changing circumstances:

Although the Companies are not aware of any ECAC-related PIMs that would be appropriate for Hawaii, there are ways to improve the current ECAC. As the Companies integrate more renewable energy onto their systems, the target heat rates for fuel types that were established in the last rate case may become misaligned with the current operating conditions of the Companies' generating limits. To keep the efficiency incentive properly aligned, target heat rates could be reset on an annual basis, instead of during a rate case - with a process that would provide the Consumer Advocate and the Commission ample

¹⁸⁷Order No. 32501, PUC-IR-3.

¹⁸⁸CA Response to PUC-IR-3 at 13.

¹⁸⁹CA Response to PUC-IR-3 at 16.

¹⁹⁰CA Response to PUC-IR-3 at 16.

time to review and approve the requested target heat rate changes. Other refinements could include establishing separate target heat rates for different types of generators that use the same fuel type, and the replacement of target heat rates with 100% pass-through of fuel costs for fuel types that are used intermittently or that are expected to be used in fixed quantity.¹⁹¹

The changes identified in the Companies' Response include: (a) establishing a process for resetting target heat rates annually (as noted above); (b) widening the deadbands around the target heat rates as appropriate; (c) establishing separate heat rates for different types of generators of the same fuel type; and (d) utilizing straight dollar for dollar pass-through for certain units used in balancing power variability.¹⁹²

The HECO Companies also discuss the establishment of a "fuel use intensity" PIM to "provide an incentive to manage per unit consumption of fossil fuel as well as manage per unit emissions of CO₂."¹⁹³ The Companies also state that additional transparency could be provided related to the Companies' economic dispatch processes.¹⁹⁴

¹⁹¹HECO Response to PUC-IR-3 at 1.

¹⁹²HECO Response to PUC-IR-3 at 5.

¹⁹³HECO Response to PUC-IR-3 at 1 and 6-7.

¹⁹⁴HECO Response to PUC-IR-3 at 2 and HECO PUC-IR-3, Attachment 1.

Commission Findings And Conclusions

120. The commission concurs with the Consumer Advocate that changes to the ECAC should be made with great care to avoid unintended consequences. The commission finds that some of the proposals made by the parties and noted above may have potential merit. The record in this proceeding, however, is not sufficient to support major changes to the ECAC mechanisms in this Order.

121. The commission intends to further investigate possible changes to the ECAC in this proceeding. In the briefs and reply briefs required in this D&O, the parties shall address the following question:

What are the appropriate steps, processes, and timing to further consider the merits of the proposed changes to the ECAC identified in this proceeding?

122. The parties are encouraged to communicate with one another to determine and report areas of agreement and disagreement regarding both substantive and procedural matters.

VI.

Orders

THE COMMISSION ORDERS:

1. Each of the HECO Companies shall file submittals in accordance with the existing RBA and RAM tariffs by March 31, 2015, as currently scheduled, without amendments to the RAM provisions required in this Order.

2. On or before April 15, 2015, each of the HECO Companies shall file amended submittals reflecting the calculation and application of the RAM Cap and otherwise consistent with the provisions set forth in Section V.2. of this Order.

3. The effective Target Revenues for the 2015 RAM period for each of the HECO Companies shall be determined according to the RBA and RAM tariffs as amended by the provisions set forth in this Order.

4. Each of the Companies shall review the language in the currently-effective RBA and RAM tariffs, and, on or before April 15, 2015, shall submit proposed tariff changes consistent with the provisions of this Order for review by the commission.

5. The Consumer Advocate's Statement of Position regarding the Companies' 2015 RBA and RAM submittals shall be filed on or before May 15, 2015, instead of on or before April 30, 2015.

6. The timing for protests and effective date for the RBA Rate Adjustment in the absence of protests shall remain as provided in the RBA tariff.

7. Within sixty (60) days of the date of this Order, the parties shall submit simultaneous initial briefs that address the following issues:

- (a) Whether and, if so, how the conventional PIMs proposed by the Consumer Advocate, by the HECO Companies, and by other parties should be refined and implemented in this Docket?
- (b) What are the appropriate steps, processes, and timing for determining measures to improve the efficiency and effectiveness of the general rate case filing and review process?
- (c) What are the appropriate steps, processes, and timing to further consider the merits of the proposed changes to the ECAC identified in this proceeding?

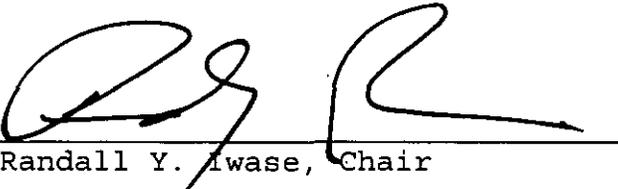
8. Within seventy-five (75) days of this Order, the parties may submit reply briefs on the issues identified in Ordering Paragraph No. 7.

9. The Companies and Consumer Advocate shall develop standards and guidelines for eligibility of projects and determination of the amount of eligible cost recovery above the RAM Cap or outside of the RAM mechanism through the REIP or other adjustment mechanism and shall present these to the Commission for approval on or before June 15, 2015.

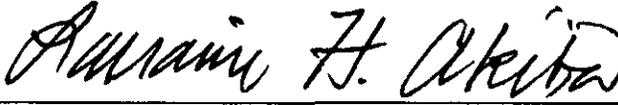
The other parties may file comments to this filing on or before June 30, 2015. Notwithstanding this directive, the HECO Companies may file an application for approval of a Major Project at any time consistent with this Order.

DONE at Honolulu, Hawaii MAR 31 2015.

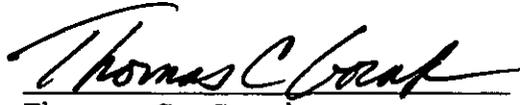
PUBLIC UTILITIES COMMISSION
OF THE STATE OF HAWAII

By 
Randall Y. Iwase, Chair

By 
Michael E. Champley, Commissioner

By 
Lorraine H. Akiba, Commissioner

APPROVED AS TO FORM:


Thomas C. Gorak
Commission Counsel

2013-0141.ljk

APPENDIX A

ORDER NO 31635 - SCHEDULE B SPECIFIC ISSUES

- GENERAL ISSUE: WHETHER PERFORMANCE INCENTIVES SHOULD BE INCORPORATED INTO THE RBA, RAM OR OTHER UTILITY RATE DESIGNS OR RATEMAKING PROCEDURES.

The specific issues to be addressed with respect to this general issue are as follows:

1. NATURE AND FORM OF PERFORMANCE INCENTIVES:
 - a. What goals or outcomes are appropriate objectives for implementation of performance incentives or penalties?
 - b. What metrics can be identified to determine the utilities' performance and attainment of objectives that are sufficiently: (1) feasible to determine objectively; (2) accurate in measuring attainment; and (3) immune from gaming or arbitrary influence by unrelated circumstances.
 - c. Can any identified performance incentives or penalties be administered feasibly, accurately, fairly and without unreasonable administrative or regulatory burden, in conjunction with other existing or anticipated regulatory mechanisms?

2. INCENTIVES TO CONTROL COSTS:

Whether the decoupling mechanisms, in conjunction with the present reliance on multiple automatic rate recovery and tracking mechanisms, sufficiently maintain and enhance incentives for the HECO Companies to control costs?

- a. What are the existing incentives/penalties to the HECO Companies to control costs?
- b. What effects do the existing decoupling mechanisms have on the incentives to the HECO Companies to control costs?
- c. In what ways, if any, do the existing decoupling mechanisms enhance incentives for the Companies to control costs?
- d. What possible modifications can be made to the RBA and RAM provisions to provide an incentive for the Companies to control costs either through rewards or penalties?

3. INCENTIVES TO MAKE NECESSARY AND/OR APPROPRIATE

CHANGES TO UTILITY STRATEGIC PLANS AND ACTION PLANS:

Whether the decoupling mechanisms overly insulate the HECO Companies from the need or urgency to make major adjustments to utility strategies and action plans that are in the public interest?

- a. In what ways do the existing decoupling mechanisms decrease utility exposure to financial or operational risk?
- b. In what ways, if any, do the existing decoupling mechanisms affect utility incentives to adjust strategic plans and Action Plans?
- c. With the substantial assurances of revenue recovery provided by the decoupling mechanisms, what incentives do the HECO Companies have to make strategic changes or adjust Action Plans?
- d. What modifications can be made to the RAM and/or RBA provisions that would provide appropriate incentives/penalties for the HECO Companies to make major adjustments to utility strategies and action plans that are in the public interest?

4. FAIR ALLOCATION OF RISK AND ASSOCIATED COSTS:

Whether the effects and shifts in financial risks between the HECO Companies and their ratepayers that result from the decoupling mechanisms are fairly compensated in determinations of associated costs of capital allowed in rates?

- a. What are the effects and shifts in financial or other risks and costs that result from the existing RBA and RAM decoupling mechanisms?

- i. What proportions of the risks and costs are attributable to the RBA and what proportions are attributable to the RAM?
 - ii. Can these risks and costs be quantified? If so, how?
 - b. Do the existing decoupling mechanisms provide any net benefits or costs to customers?
 - i. Can the net benefits or costs be quantified? If so, how?

5. LEGISLATIVE GUIDANCE:

Whether potential economic incentives/penalties could be utilized to reward significant, accelerated efforts to reduce costs, improve customer service and otherwise provide affordable rates? How could performance incentives, penalties or other measures address the concerns expressed by the 2013 Hawaii State Legislature in connection with Senate Bill 120, Session Laws of Hawaii 2013, which authorizes the commission "to establish a policy to implement economic incentives and cost recovery regulatory mechanisms, as necessary and appropriate, to induce and accelerate electric utilities' cost reduction efforts, encourage greater utilization of renewable energy, accelerate the retirement of utility fossil

generation, and increase investments to modernize the State's electrical grids."¹⁹⁵

- GENERAL ISSUE: WHETHER THE RAM MECHANISM SHOULD BE AMENDED, TERMINATED OR REPLACED.

The specific issues to be addressed with respect to this general issue are as follows:

6. CHANGES OR ALTERNATIVES TO THE EXISTING RAM:

What changes or alternatives to the existing RAM would be appropriate to address the issues identified above?

7. CONSIDERATIONS REGARDING SUBSTANTIAL AMENDMENT TO OR TERMINATION OF THE RAM:

What corollary matters need to be addressed if the RAM is substantially amended or terminated as a result of Commission order or otherwise in this proceeding?

- a. Would changes in utility rate of return be necessary or appropriate if the RAM is substantially amended or terminated?
- b. Would the existing provisions for a three-year general rate case cycle need to be amended or

¹⁹⁵Senate Bill 120, Session Laws of Hawaii 2013, Section 1 at 3.

terminated if the RAM is substantially amended or terminated?

- i. To what extent is the continued implementation of the RAM necessary to maintain a three-year rate case cycle?
 - ii. Should more frequent general rate cases be considered as an alternative to the provisions for a three-year rate case cycle?
- c. What specific aspects of the Stipulated Agreement would need to be considered and resolved if the RAM is substantially amended or terminated?¹⁹⁶
- d. What is the appropriate timing and venue for implementing any effective changes to the RAM?
- i. Should amendments or termination to the RAM be decided and made effective in this proceeding?
 - ii. Should amendments or termination of the RAM be made effective in subsequent general rate

¹⁹⁶ See the Joint Statement of Position of the Hawaiian Electric Companies and Consumer Advocate on the Constraints of the Stipulated Settlement Agreement, filed in this docket on June 20, 2013 ("Joint Statement"), regarding the Stipulated Settlement Agreement, filed on January 28, 2013, in Docket No. 2008-0083 ("Stipulated Agreement").

case proceedings or other specific proceedings?

iii. Do the terms of the Stipulated Agreement limit or affect the appropriate timing for implementing amendments or terminations of the RAM?

- GENERAL ISSUE: WHETHER CHANGES SHOULD BE MADE TO GENERAL RATEMAKING PROCEDURES TO IMPROVE EFFICIENCY AND/OR EFFECTIVENESS.

The specific issues to be addressed with respect to this general issue are as follows:

8. What changes could be made to existing general rate case filing and review procedures to improve the efficiency and effectiveness of regulatory oversight?
 - a. Could lessons learned from the standardization of the annual RBA and RAM filings be applied to general rate case filing procedures?
 - b. Should postage-stamp rates for all three HECO Companies with consolidated general rate case filings be considered to reduce the number of general rate cases and address inter-utility equity regarding RPS compliance?

- c. Should any of the Commission's administrative rules be amended or revised to improve the rate case process?
- d. What changes should be made to provide more timely recovery of costs and reduce regulatory lag?

9. ADMINSTRATIVE EFFICIENCY:

Whether and how the implementation and annual review of the decoupling mechanisms can be simplified?

- a. What changes to the decoupling mechanisms, filing procedures or review procedures could be made to improve the efficiency, transparency and/or accuracy of the implementation and annual review of the decoupling mechanisms?

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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