HECO T-6
DOCKET NO. 03-0371

TESTIMONY OF
WILLIAM A. BONNET

VICE PRESIDENT
GOVERNMENT AND COMMUNITY AFFAIRS
HAWAIIAN ELECTRIC COMPANY, INC.

Subject: Regulatory Policy Matters

INTRODUCTION

Q. Please state your name and business address.

A. My name is William A. Bonnet and my business address is 1001 Bishop Street, Suite 811, Honolulu, Hawaii.

Q. What is your present position with the Hawaiian Electric Company, Inc. ("HECO")?

A. I am the Vice President of Government and Community Affairs. My educational background and experience are provided in HECO-600.

Q. Who do you represent in this submittal of testimonies and exhibits?

A. The testimonies submitted represent the positions of HECO, HELCO and MECO. For convenience, our testimonies and exhibits are marked as "HECO". Throughout this submittal, when we refer to HECO, HELCO and MECO together, we refer to them either as "HECO" or the "Companies". Where it is important to distinguish between the Companies or the Islands, we have identified the particular company or island.

Q. What is the Companies' understanding of the purpose of this proceeding?

A. As stated in Order No. 20582, the purpose of the proceeding is to examine the potential benefits and impacts of distributed generation on Hawaii's electric distribution systems and market. Distributed generation involves the use of small scale electric generating technologies installed at, or in close proximity to, the end-user's location. As stated in Order No. 20582 the objective of this proceeding is to develop polices and a framework for distributed generation projects deployed in Hawaii.

Q. What is the scope of your testimony?

A. My testimony will:

1) Summarize the Companies' regulatory policy position regarding combined heat and power ("CHP") systems and the Companies' proposed CHP Program.

2) Discuss the roles of the regulated utilities and the Commission in the deployment of DG in Hawaii (covering Issue #3).

3) Discuss the revisions that should be made to state administrative rules and utility rules and practices to facilitate the successful deployment of DG (covering Issue #13).

4) State the Companies' position with respect to the general issues regarding distributed generation raised in the informal complaint (Issue #14).

REGULATORY POLICY POSITION

Q. What steps have the Companies taken to implement CHP Programs?

A. The Companies filed an Application on October 10, 2003 in Docket No. 03-0366 requesting approval of each Company's proposed CHP Program and related tariff provision (Schedule CHP, Customer-Sited Utility-Owned Cogeneration Service). Under the CHP Program and Schedule CHP, the Companies propose to offer CHP systems to eligible utility customers on the islands of Oahu, Maui and Hawaii as a regulated utility service. The Application requests that the Commission (1) approve each Company's CHP (Combined Heat and Power) Program and initial 5-year budget of capital expenditures for the program, subject to the flexibility provisions included in the application, and (2) approve each Company's proposed Schedule CHP, Customer-Sited Utility-Owned Cogeneration Service ("Schedule CHP"), the proposed standard form CHP Agreement and Eligibility Criteria, and modified Energy Cost Adjustment Clause ("ECAC") provision.

Implementation of the CHP Programs was scheduled to begin in 2004, if authorized by the Commission.

Q. Have the Companies' proposed CHP Program proceeded?

A. No. By Order No. 20831, issued March 2, 2004 in Docket No. 03-0366, the Commission ordered that the CHP Program application "is suspended until further order of the Commission." The Commission indicated that this DG docket is intended to "form the basis for rules and regulations deemed necessary to govern participation into Hawaii's electricity market through distributed generation."

Q. What has been the result of such suspension?

A. As a result, the Companies' have not been able to proceed with their CHP Programs.

Q. Why have the Companies requested Commission approval to offer CHP systems to customers as a regulated utility service?

A. The reasons for the proposed service are detailed in the CHP Program application and are summarized in Mr. Seu's testimony, HECO T-1. I would like to emphasize why the proposed program is appropriate from a regulatory policy perspective.

Hawaii's electric utilities cannot just be in the business of offering central station generation, as they have been told by legislators, by regulators, by the press, by the public and by their customers. They must be able to offer their customers an expanded array of choices that promote the State's energy objectives of having a reliable and affordable energy infrastructure, while promoting energy efficiency and the use of renewable resources.

The objectives of promoting combined heat and power systems ("CHP") should be to encourage energy efficiency, to accelerate the implementation of

cost-effective CHP, to provide customer choices, and to take into account the interests of all customers. These are all utility objectives. Installing, owning, operating and maintaining CHP as a regulated utility will substantially further all of these objectives.

Q. How are the interests of all customers taken into account?

A. The interests of all customers are taken into consideration primarily by structuring the program of installing utility-owned CHP systems so that non-participating customers are not burdened. If the electric utility is allowed to participate in the CHP market as a regulated entity, the Commission must approve the Companies' Schedule CHP tariff filing, and/or individual CHP Rule 4 project filings, and the Commission, with input from the Consumer Advocate, has the authority to regulate the Companies to ensure that the interests of all customers are taken into consideration.

Q. Are there additional reasons that the Companies should be allowed to pursue their proposed CHP Programs and other CHP projects with customers under special service contracts (termed Rule 4 contracts) as soon as possible?

A. There are several reasons, one of which is primarily applicable to HECO. As discussed by Mr. Sakuda in HECO T-3, HECO has an urgent need for firm generating capacity. Even with HECO's forecasted firm capacity contributions of the Companies' proposed CHP program, in combination with the energy efficiency and load management DSM program impacts, new firm capacity would be needed in 2006. Given the long lead-time required to install the next generating unit, it is not possible to have a unit installed and operating by 2006. Since the next generating unit cannot be installed by 2006, options to mitigate the effects of the higher peak forecasts, including being allowed to proceed with a

CHP program and/or CHP installations as soon as possible, is necessary.

Q. What are the reasons applicable to all of the Companies?

A. The first reason is to be able to meet the reasonable needs and expectations of their customers. The second is to avoid negative impacts on non-participating customers due to the unnecessary loss of revenues if a customer installs a third-party CHP system.

With respect to the first point, there are a number of commercial customers that are ready to proceed now with CHP systems. Some of these customers want to install CHP in connection with expansions or renovations of their operations or hotel facilities.

With respect to the second point, some customers may install third-party CHP systems rather than continue to wait for regulatory proceedings to conclude in "due course". As discussed in earlier testimonies, the Companies' proposed CHP Program is predicated not only on offering new energy-efficient options to commercial customers and addressing load growth, but also on protecting the interests of the Companies' non-participating customers. Simply stated, non-participating customers should be better off when the Companies own, operate and maintain cost-effective customer-sited CHP systems, than when the systems are installed by third-parties (and the electric revenue displaced by such systems are lost).

Q. Pending the conclusion of this proceeding, why should the Commission allow the Companies to at least proceed with specific Rule 4 contracts?

A. In opening this proceeding, the Commission indicated:

> "Since it would be unreasonable to defer consideration of all future related filings with the commission that may be affected by this proceeding, the commission may consider

> these related matters on a case-by-case basis. To the extent that there is a public interest served in determining an outcome in these matters prior to the completion of this proceeding, we will do so. Such an outcome, however, may need to be interim in nature, pending our final disposition of this docket."

The Commission has already recognized that it should not defer consideration of all related filings. Given the load growth projections, the Commission should consider the Rule 4 contracts the Companies' plan to submit to the Commission, even if this proceeding has not concluded.

Q. How would the Companies' proceed with CHP?

A. The Companies plan to file applications for approval of contracts entered into under Rule 4 of its Tariffs for the installation of CHP projects on a customer-by-customer basis. The Companies strongly encourage the Commission to consider approving the Rule 4 contracts on a case-by-case basis, pending the outcome of this proceeding (and the CHP Program docket). The CHP systems installed pursuant to the contracts are an important part of addressing (1) the load growth situation, especially on Oahu, (2) the needs of our customers, and (3) the interests of non-participating customers.

Q. Do you have any other comments regarding the delay in implementing CHP by the Companies?

A. Delaying the start of the program for any significant period of time would irrevocably harm ratepayers, the Companies and CHP Program customers. Load is growing faster than was anticipated, particularly on Oahu. Even with central station deferral benefits expected from their CHP programs, the need dates for new generation are sooner than when new generation can be added to the system. The installation of utility-owned CHP systems can help avoid reserve margin shortfalls.

The standard criticism of regulated utilities and of regulation has been that they are too slow to respond to changed circumstances. In this case, however, the Companies have defied conventional wisdom by recognizing that circumstances have indeed changed, and by expeditiously responding with an aggressive, new program.

Q. The assertion has been made that Hawaii should follow the lead of some mainland jurisdictions, and move away from or even require divestiture of utility-owned generation. How do you respond to such an assertion?

A. The mainland model touted by some has not been adopted across the board, and has proven to be problematic in states like California, as the Commission recognized in its proceeding on electric competition, Docket No. 96-0493. (See Decision and Order No. 20584, issued October 21, 2003, pages 9-14.)

More importantly, mainland models cannot be applied to Hawaii without recognizing the differences between Hawaii and the Mainland.

Q. In what ways is Hawaii unique?

A. The conditions arguably making electric industry restructuring feasible in certain Mainland jurisdictions were not and are not present in Hawaii. None of the island electric systems are interconnected. There is only one electric utility on each island. The firm power non-utility generators have insisted on and received long-term power purchase agreements with the electric utility serving the island on which their facilities are located. "Cheap" natural gas, which turned out to be elusive in jurisdictions like California, certainly is not available in Hawaii.

Issue No. 3

Q. Issue No. 3 addresses the roles of the regulated electric utility companies and the Commission in the deployment of distributed generation in Hawaii. What are the

respective roles?

A. The roles of the utility and the Commission with respect to DG depend on the DG application. In response to Issue No. 1, Mr. Seu (HECO T-1) identified seven categories of DG application. The role of the utility with respect to each DG application is as follows:

1) Customer-sited emergency generation: A few utilities have provided such service under tariff, with or without the right to use the emergency generators for peaking purposes when there is a capacity shortage, but the Companies do not currently anticipate providing such a service. Therefore, the role of the utility is to enforce tariff provisions, which require that such generation not be operated in parallel with the utility grid.

2) Substation-sited peaking generation: The Companies have used and intend to continue to use DG for this purpose under appropriate circumstances.

3) Substation-sited generation to address case-specific T&D problems: The Companies have implemented and intend to continue to implement DG for this purpose in appropriate circumstances.

4) Customer-sited CHP systems: The Companies intend to offer CHP systems under circumstances where it is cost-effective for the utilities to do so, and offering such a service does not unduly burden non-participating customers. With respect to customer-sited CHP systems or other DG owned by the customers or third-parties, the utility's role is to develop and enforce interconnection standards, which the Companies have done by filing a Tariff Rule 14.H. The utility also provides back-up and supplemental service to the customers. The utilities must design and obtain approval for utility tariff provisions that ensure the utility customers will not be unduly burdened by

the provision of utility back-up service to customers with customer-sited CHP systems or DG.

5) Customer-sited cogeneration: The Companies do not intend to offer such a service, but would consider owning such facilities on a case-by-case basis (for example, when such ownership would facilitate installation of a biomass plant that would contribute to meeting RPS goals). For non-utility cogeneration operated in parallel with the utility grid, the utilities develop and enforce interconnection standards, and provide back-up and supplemental service. Where excess power is exported to the utility system, the utilities negotiate power purchase and interconnection agreements based on Commission-adopted rules and principles enunciated by the Commission in power purchase dockets. As stated earlier, power purchase arrangements are beyond the scope of this proceeding.

6) Off-grid, customer-sited generation: The Companies do not intend to offer such a service. Thus, the utilities do not have a role in the deployment of off-grid DG.

7) Customer-sited generation for power purposes only: The Companies do not intend to offer such systems, but would consider DG for this purpose on a case-by-case basis if such an application becomes a cost-effective utility option. The utility's role for non-utility DG is the same as its role for non-utility CHP systems.

Q. What would be the Commission's role with respect to each DG application?

A. With respect to utility proposals for substation-sited peaking generation and substation-sited generation to address case-specific T&D problems, the Commission's role is to review such proposals under paragraph 2.3.g.2 of General

Order No. 7.

With respect to utility offerings of CHP systems, the Commission's role is to review the application for a CHP Program as it would other supply-side planning tools under the criteria included in the IRP Framework, and to review the proposed tariff provision (Schedule CHP, Exhibit E to CHP Application), the Eligibility Criteria (see, CHP Application, pages 31-33, and Exhibit E, Attachment I), and the program budget and budget flexibility provisions (CHP Application, pages 11-13) in order to determine whether the program will address its intended purposes. In the Companies' view, it is appropriate for contracts filed under an approved CHP program to be reviewed under a file and suspend process, for the reasons explained in the CHP Application (pages 34-36).

The utility also plans to request approval for the installation of CHP systems that may fall outside the scope of the CHP program. The Commission's role would be to review applications for approval of the Rule 4 contracts under paragraph 2.3.g.2 of General Order No. 7 and to determine the consistency of these individual projects with the overall objectives of the CHP program (e.g., to review the consistency of the form of contract and the pricing structure with that included in the CHP program).

In the case of CHP systems and DG operated in parallel with the utility's grid system, the Commission's role is to investigate the impacts of such DG on the utility system, as it is doing in this proceeding, and review utility tariff provisions relating to the interconnection of such facilities to the utility grid and the utility's provision of back-up and supplemental service, as the Commission has done in other proceedings.

Finally, in the case of customer-sited CHP systems and DG owned by third-

parties, the Commission's role is to review whether the retail sale of electricity by such third-party owners falls within the purview of the public utility statutes. To date, the Companies have not take the position that these third-party owned installations should be regulated by the Commission, due to the relatively small number of such installations.

Issue #13

Q. Issue No. 13 addresses revisions that should be made to state administrative rules and utility rules and practices to facilitate the successful deployment of distributed generation. Please summarize the Companies' position.

A. In order to facilitate the successful deployment of DG, the Commission should approve the Companies' proposed CHP program and CHP tariff, and expeditiously review and approve applications for individual CHP projects under Rule 4 of the Companies' tariffs. The Companies' CHP programs and tariffs are designed to enable them to respond to the needs of CHP customers in a timely and efficient manner, by streamlining the review and approval process.

The Companies' proposed CHP program falls within the definition of the "successful deployment of distributed generation", because the CHP installations would be cost-effective in the IRP sense (based on the quantifiable and qualitative costs and benefits addressed in the CHP Application) and would facilitate customer choice. The "successful deployment of distributed generation" also should avoid undue impacts on utility systems, and on non-participating utility customers. Steps have already been taken to address the impacts on utility systems through the deployment and approval of Tariff Rule 14.H. The Companies' participation in offering CHP systems through their proposed CHP programs and Rule 4 contracts would help avoid undue impacts on non-

participating customers.

Issue #14

Q. Issue No. 14 is stated as follows: "The Parties and Participants may also address general issues regarding distributed generation raised in the informal complaint file[d] by Pacific Machinery, Inc., Johnson Controls, Inc. and Noresco, Inc. against HECO, MECO and HELCO on July 2, 2003 (Informal complaint No. IC-03-098), but not specific claims made against any of the Parties named in the complaint." This issue, as modified by the Commission, was included by the Parties in response to the Commission's stated intent (in Order No. 20582, page 2, footnote 1) to also address the issues raised in the informal complaint in this proceeding. Please summarize the Companies' position.

A. The Companies' positions on general issues raised in the informal complaint are provided in the Companies' positions with respect to Issue Nos. 1 through 13.

SUMMARY

Q. Please summarize your testimony.

A. The Companies have provided six testimonies to support the reasons for and benefits of utility participation in the provision of CHP systems. The provision of CHP services by utilities is a natural step in the evolution of electric utility services, and electric utility customers should have the option of acquiring CHP systems from Hawaii utilities.

The Commission has already recognized that it should not defer consideration of all related filings to this proceeding. Given the load growth projections for Oahu, the needs of CHP customers, and the interests of all utility customers, the Commission should consider the Rule 4 contracts the Companies'

plan to submit to the Commission.

Q. Does this conclude your testimony?

A. Yes, it does.