

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF HAWAII

In the Matter of the Application of)
)
PUBLIC UTILITIES COMMISSION) DOCKET NO. 03-0372
)
Instituting a Proceeding to Investigate)
Competitive Bidding for New Generating)
Capacity in Hawaii.)

DIVISION OF CONSUMER ADVOCACY'S

FINAL STATEMENT OF POSITION
APPENDICES F1 AND F2

AND

CERTIFICATE OF SERVICE

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I. INTRODUCTION.

A. UPDATE TO THE PROCEDURAL HISTORY.

With Order No. 20583 dated October 21, 2003, the Public Utilities Commission of the State of Hawaii ("Commission") instituted a generic proceeding in Docket No. 03-0372 to investigate the merits of using competitive bidding as a mechanism for acquiring or building new generating capacity for Hawaii. Hawaiian Electric Company, Inc. (HECO), Maui Electric Light Company, Inc. ("MECO"), Hawaii Electric Light Company, Inc. ("HELCO") (HECO, MECO and HELCO collectively are referred to as the "HECO Companies") and Kauai Island Utility Cooperative ("KIUC") (collectively with the HECO Companies referred to as the "Electric Utility Companies"), and the Division of Consumer Advocacy ("Consumer Advocate") were made parties to the docket.

The Department of Business and Economic Development and Tourism ("DBED&T"), The Gas Company, the County of Kauai, the County of Maui, Hawaii Renewable Energy Alliance ("HREA"), Johnson Controls, Inc., Pacific Machinery, Inc., and Hess Microgen, LLC all were allowed to participate, either as Intervenors or

Participants. Pacific Machinery, Inc., DBED&T, the County of Maui, and The Gas Company subsequently filed, and the Commission has approved their Notices of Withdrawal.

In keeping with the procedural schedule established by the Commission, an initial statement of position (also, "SOP") was filed on or before March 14, 2005 by the Consumer Advocate, the HECO Companies, KIUC, the County of Kauai, the County of Maui, HREA, and Hess Microgen. An initial round of information requests was issued among the parties on, or before April 4, 2005, including information requests by: (1) the Consumer Advocate to the HECO Companies and (2) the HECO Companies and HREA to the Consumer Advocate. Responses to the initial round of information requests were filed with the parties and Commission on or before April 28, 2005. Information requests were issued by the Commission to all parties in the proceeding on May 13, 2005, and responses were submitted on or before June 9, 2005.

In keeping with the procedural schedule established by the Commission, this document presents the Consumer Advocate's Final Statement of Position.

B. SUMMARY – CONSUMER ADVOCATE'S FINAL POSITION.

This Section summarizes the Consumer Advocate's final position. The Commission should require competitive bidding as the primary mechanism for resource acquisition by Hawaii's electric utilities. There is broad agreement among the parties that competitive bidding can bring important benefits to Hawaii. The Electric Utility Companies are fully capable of conducting competitive solicitations at the present time. Thus, competitive bidding can be implemented with little, if any, additional regulatory

processes. In short, there is no reason to delay its implementation and the benefits that it offers consumers.

1. Competitive Bidding Can Bring Important Benefits.

The parties to this proceeding are fully in agreement that competitive bidding, if implemented effectively, can bring important benefits to Hawaii's electric consumers. The Consumer Advocate continues to maintain that competitive bidding can produce substantial benefits for Hawaii (Issue No. 1), for the reasons discussed in detail in Section II. of the Consumer Advocate's Initial Statement of Position. The important conclusions are that competitive bidding in Hawaii can:

- Expand the resource options considered in meeting an identified need, thereby increasing the range of products that are available to consumers;
- Create an opportunity for consumer savings by imposing price competition among resource options and removing the link between prices paid for incremental resources and utility avoided costs;
- Increase efficiency in the allocation of Hawaii's resources by allowing non-utility providers to develop creative responses to specific resource needs;
- Improve resource supply markets in Hawaii by fostering a healthy competitive climate that encourages the introduction of innovative resource options; and
- Improve the responsiveness of utility resource plans to achieve environmental, fuel diversity and other public policy goals by removing barriers to developers with innovative resource proposals.

Other parties have presented similar lists in their Initial Statements of Position. Accordingly, the Commission should conclude that competitive bidding can bring important benefits to Hawaii.

2. A Fair Competitive Bidding System Can Be Developed To Ensure Benefits.

The Consumer Advocate's Initial Statement of Position discussed the manner in which a fair bidding system can be developed to achieve the identified benefits (Issues No. 2.a. through 3). As is discussed in greater detail in Section II. below, there is a great deal of agreement among the parties to this proceeding regarding how competitive bidding should be implemented.

Notably, the Consumer Advocate and the HECO Companies¹ appear to agree that: (1) competitive bidding should be implemented as part of the Commission's Integrated Resource Planning ("IRP") framework, (2) that the Electric Utility Companies should be free to develop the details of the Request for Proposal ("RFP") design and implementation, and (3) the Commission should maintain a critical oversight role.

The Consumer Advocate continues to recommend that the Commission take the following specific actions, as discussed in Section III. of its Initial Statement of Position:

- The Commission should require competitive bidding as the mechanism by which new capacity and energy resources will be procured in Hawaii;
- The Commission should recognize that competitive bidding belongs as an integral part of its IRP Framework;
- The Commission should adopt a method for determining avoided costs that is consistent with all-source competitive bidding;
- The Commission should amend its IRP Framework provisions requirements that will achieve the benefits of competitive bidding by

¹ Here, the Consumer Advocate does not intend to diminish the recommendations of the other Parties to the proceeding that also are supportive of this basic construct. However, the Consumer Advocate emphasizes the important similarities with the position of the HECO Companies because of their apparent resistance to a Commission requirement in the instant proceeding that competitive bidding be used in Hawaii to procure resources, as evidenced in their Initial SOP and information request responses.

improving the information available to stakeholders in deciding among alternate procurement strategies;

- The Commission should establish its critical oversight role regarding competitive bidding practices;
- The Commission should avoid being prescriptive regarding how competitive bidding processes are to be conducted, and instead state clearly that utilities must adhere to “best practices;”
- The Commission should define the role of the host utility vis-à-vis its own competitive bidding process; and
- The Commission should identify the Commission review processes that would apply to a successful bidder.

The above actions will support a fair, competitive bidding system that can ensure that competitive bidding achieves benefits without placing ratepayers at undue risk and can be accomplished through the following five straightforward steps.

- The Commission issues a Decision and Order establishing competitive bidding as the mechanism by which new capacity and energy resources will be procured;
- A utility, in keeping with the Commission’s established IRP Framework and in coordination with its IRP Advisory Group, identifies (a) a need for additional capacity or energy resources and (b) the types of resources to be procured;
- The utility designs its proposed RFP and associated RFP documentation;
- The utility obtains Commission approval of its proposed RFP and associated documentation; and
- The utility issues its Commission-approved RFP.

3. Competitive Bidding Can and Should Be Established Without Further Delay.

As discussed in Section II.B. below, the most significant point of disagreement at this juncture appears to reside between the HECO Companies and the Consumer Advocate regarding timing. The HECO Companies argue that an additional regulatory proceeding must occur before competitive bidding can be required by the Commission. The Consumer Advocate disagrees.

The HECO Companies' position is not well supported. KIUC has used, and intends to continue using competitive bidding processes for resource additions. The HECO Companies themselves have used, and continue to use competitive bidding processes. The above actions clearly demonstrate that another proceeding is not required to obtain a Decision and Order from the Commission requiring the use of a competitive bidding process to procure resources. The utilities have already demonstrated that the process can be followed without Commission direction.

C. OVERVIEW OF THIS DOCUMENT.

This document emphasizes and supplements the conclusions and recommendations set forth in the Consumer Advocate's Initial Statement of Position, and is organized by section, as follows:

- Section I provides a recap of the conclusions and recommendations presented in the Consumer Advocate's Initial Statement of Position, and introduces the Consumer Advocate's final position and recommendations for resolution of this docket;
- Section II provides a summary of the many important points regarding the implementation of competitive bidding where at least some parties seem to be in agreement with the Consumer Advocate, then provides a brief discussion of the essential difference between the

Consumer Advocate's and the HECO Companies' recommendations as set forth in their respective statements of position;

Section III provides several clarifications to the Consumer Advocate's Initial Statement of Position; and

Section IV provides the Consumer Advocate's conclusions.

II. COMPARISON OF THE CONSUMER ADVOCATE'S AND THE HECO COMPANIES' POSITIONS.

This docket raises a range of issues regarding the implementation of competitive bidding for resource procurement in Hawaii. A review of the positions set forth in the Parties' initial statements of position and responses to information requests posed by other Parties and the Commission reveals that there is considerable agreement regarding many key issues. The most significant difference is the HECO Companies' recommendation that an additional proceeding be initiated by the Commission. Section II.A. presents the important areas of agreement, and Section II.B. addresses the issue that is the focus of disagreement.

A. THERE ARE MANY AREAS OF AGREEMENT.

The Consumer Advocate is encouraged by the positions offered to-date by the Parties in the instant proceeding regarding the feasibility of requiring a competitive bidding process for the procurement of needed supply- and demand-side resources in Hawaii. Having reviewed the initial statements of position and information request responses of the HECO Companies, the Consumer Advocate finds that there is substantial agreement among the parties – including the HECO Companies – on a

broad range of important issues. Based on this review, the Consumer Advocate finds substantial agreement between it, the HECO Companies, and at least some of the other parties on the following key issues:²

- If implemented properly, competitive bidding can yield a number of important benefits for Hawaii (see HECO Companies' Initial SOP, Exhibit A at 1-4). The Consumer Advocate observes that in addition to the HECO Companies, KIUC and virtually all other parties to this proceeding support this conclusion;
- Identification of the best option for customers can only be achieved, if resource options are allowed to compete (see HECO Companies' Initial SOP at 9);
- Competitive bidding might not be desirable in all circumstances, such that some form of exception should be available (see HECO Companies' Initial SOP at 2, and HECO Companies' response to PUC-IR-40(a));
- Competitive bidding should proceed within the context of the Commission's IRP Framework, with the IRP Action Plan establishing the parameters of the RFP (see HECO Companies' Initial SOP at 13, Exhibit A at 20). The County of Kauai appears to support the integration of competitive bidding processes and utility integrated resource plans (County of Kauai's Initial SOP at 1); (see also HREA's Initial SOP at 16-19; and KIUC's Initial SOP at 8);
- Additional rules are not necessary to implement competitive bidding (see HECO Companies' response to PUC-IR-28);
- The Commission could establish basic "guidelines" to govern competitive bidding in Hawaii (the Consumer Advocate's position on "guidelines" is explained below; see HECO Companies' response to PUC-IR-24, at 1; HREA's response to PUC-IR-25(a); and County of Kauai's response to PUC-IR-25(a)). HREA recommends "principles" based on the possible application of one or both of two models that it describes in its initial SOP at 11-12; see also KIUC's Initial SOP at 8;

² Once again, in placing a focus on the HECO Companies in this summary, it is not the Consumer Advocate's intention to diminish the positions of other parties. Rather, the Consumer Advocate seeks to demonstrate that the HECO Companies' position appears quite close to that of the Consumer Advocate, notwithstanding their apparent resistance to the required implementation of competitive bidding via a Commission Decision and Order in this proceeding.

- The “details” of the design and implementation of individual solicitations should be left to the sponsoring utility, subject to Commission oversight, such that each utility would “structure the competitive bidding process to meet its individual circumstances and requirements within established guidelines” (see HECO Companies’ response to PUC-IR-31, at 1, and PUC-IR-67, at 2);
- The characteristics of successful competitive bidding processes can be specified, including, for example, requirements that such processes be fair and equitable to all bidders, and incorporate “transparent” evaluation criteria and a proposed purchase contract (see HECO Companies’ Initial SOP, Appendix A at 30-31, 41; and HECO Companies’ response to PUC-IR-68, at 1; 72, 73). Hess Microgen appears to support these views (Hess Microgen’s Initial SOP at 1); see also HREA’s Initial SOP at 15;
- A wide range of supply-side options must be eligible to participate in competitive bidding processes (see HECO Companies’ Initial SOP, Appendix A at 26);
- DSM options should be considered, but might require some separate treatment, i.e., outside of supply-side RFPs (see HECO Companies’ Initial SOP at 11);
- Competitive bidding processes may differ depending on the type of resources to be acquired (see HECO Companies’ response to PUC-IR 44, at 1; HREA’s Initial SOP at 13);
- All relevant costs should be considered in evaluating resource proposals (see HECO Companies’ Initial SOP, Exhibit A at 23);
- There is a role for the host utility with respect to allowing it to respond to its own solicitation because: (1) not allowing the utility to bid could eliminate the lowest cost or most viable option (see HECO Companies’ Initial SOP, Appendix A at 4) and (2) some “backup” to the RFP might be necessary to ensure system reliability (see HECO Companies’ response to PUC-IR-16 and PUC-IR-19);
- The Commission must play an important role in overseeing competitive bidding processes (see HECO Companies’ Initial SOP, Exhibit A at 40; HECO Companies’ response to PUC-IR-68, at 1; HECO Companies’ response to PUC-IR-75); Hess Microgen agrees that the Commission must resolve disputes, i.e., as might relate to anti-competitive pricing as per Hess Microgen’s Initial SOP at 2; (see also HREA’s Initial SOP at 14, 15);

- Steps can and must be taken to ensure that utility “self-dealing” and unfair competitive advantage do not become concerns (see HECO Companies’ response to PUC-IR-23); and
- Costs incurred from projects selected through competitive processes should be recovered through rates (HECO Companies’ response to PUC-IR-75).

Given the above, the Consumer Advocate concludes that the areas of agreement in this docket are substantial.

B. THERE IS ONLY ONE SIGNIFICANT POINT OF DISAGREEMENT.

The only significant point of disagreement at this juncture is whether an additional regulatory proceeding must occur before the Commission can formally require a competitive bidding process be used to secure resources. The HECO Companies claim that the “details” of competitive bidding processes should be developed “in a follow-up proceeding,” which might take “several years” to complete.³

The Consumer Advocate rejects this view as being without foundation. There are three primary reasons why the Commission should view further delay of competitive bidding as unnecessary:

- The Electric Utility Companies currently use, and plan to use a competitive bidding process to secure resources (and other services necessary for them to fulfill their service obligations). KIUC states that it intends to use a competitive bidding process for its next generation addition, and that it will follow the “proven” process that was used in 1995 to secure its 26.4 megawatt generating facility (see KIUC’s Statement of Position at 3, 6). The HECO Companies also use competitive bidding today. They indicate that it is in use for the procurement of equipment and services as a cost management measure (HECO Companies’ Initial SOP, Exhibit A at 14). They indicate that they recently issued an

³ See, e.g., HECO Companies’ Initial SOP at 12.

RFP for generating supplies (see HECO Companies' response to PUC-IR-15, at 6). As noted in the Consumer Advocate's Initial Statement of Position at 16, the HECO Companies' affiliate Renewable Hawaii, Inc. recently issued an RFP soliciting competitive proposals from developers of renewable power projects.

- The Electric Utility Companies have used competitive bidding in the past to secure needed resources. As described in Section I.C.7. of the Consumer Advocate's Initial Statement of Position, the HECO Companies and KIUC have considerable past experience with competitive bidding for new resources. Indeed, the breadth and depth of the HECO Companies' initial filing and responses to information requests make clear that they are substantially familiar with the range of factors that must be considered to design and implement effective solicitation processes.
- There is an abundance of industry "know how" that is immediately available to the Electric Utility Companies to assist them in developing fair, effective competitive bidding processes. As is evidenced by the Consumer Advocate's discussion in Sections I.C.1. through I.C.6. of its Initial Statement of Position, the electric utility industry has a quarter-century of experience with competitive bidding. The HECO Companies have ready access to a wealth of information that has been accumulated. The record in this proceeding makes clear that competitive bidding is an approach that is a widely used and accepted as a practice for resource acquisition. The HECO Companies make clear in their presentation that they have done substantial research in this area and are familiar with the body of U.S. experience with competitive bidding. The Consumer Advocate is confident that Hawaii's utilities are up to the task of designing and implementing effective RFPs. The benefits of competitive bidding need not be delayed.

A fourth and final reason for rejecting the HECO Companies' recommendation lies in the fact that an additional regulatory proceeding would serve no useful purpose. The HECO Companies state that the purpose of this new proceeding would be to develop the "details" of competitive bidding processes. Indeed, the HECO Companies create the impression that there are a myriad of details that must be resolved prior to the implementation of competitive bidding in Hawaii (see, e.g., HECO Companies' Initial

SOP at 2). However, this extensive focus on “details” appears in direct conflict with other aspects of the HECO Companies’ presentation. They clearly state, for example (see HECO Companies’ Initial SOP at 8), that the utility should play “a major role” in the competitive bidding process and should be responsible for developing the details of the design and implementation of its competitive solicitation.⁴ In response to PUC-IR-31, the HECO Companies state that “the details of the evaluation process, evaluation criteria, contract provisions, economic models, input assumptions, process and schedule should all be at the discretion of the individual utility.”

The Consumer Advocate agrees with the Company that the utilities should be responsible for the details of designing and implementing solicitation processes (i.e., consistent with best practices and subject to Commission oversight). There would be no value in conducting a regulatory proceeding to establish details that would ultimately be left to the Company, or lost to advances in RFP design and implementation practices.⁵

⁴ The HECO Companies identify the tasks involved as including: (1) designing the RFP documents, evaluation criteria, and power purchase agreement; (2) managing the RFP process, including communications with bidders; (3) evaluating the bids received; (4) selecting the bids based on the established criteria; (5) negotiating contracts with selected bidders; and (6) competing in the solicitation process with a self-build option, if feasible.

⁵ A proceeding that attempts to resolve these details also would be counterproductive for reasons discussed in the Consumer Advocate’s Initial SOP, at 56-57. The HECO Companies’ statements support the Consumer Advocate’s view regarding the evolutionary nature of competitive bidding processes. For instance, they state that competitive bidding has been, and almost certainly will continue to be an evolving process in the electric industry (see the HECO Companies’ response to PUC IR 34). Fixing the details of an evolving process will be problematic, as are the implications of delaying the benefits that competitive bidding can deliver.

The HECO Companies may believe that “guidelines” for competitive bidding could be developed through a new proceeding,⁶ but again such delay is unwarranted. Question 2(b) issued by the Commission in Order No. 20923 asked the parties to provide “specific competitive bidding guidelines” and other information relevant to competitive bidding processes in this proceeding. Moreover, the HECO Companies have done little to provide insight into the specifics of what would be achieved through a future “guidelines” proceeding. They have offered little by way of organized recommendations for the specific results in this proceeding. In fact, the only suggested guideline that the Consumer Advocate is able to extract from the discussion at pages 34-41 of the HECO Companies’ Initial SOP (setting aside their extensive discussion of solicitation processes, which the HECO Companies would leave to the Electric Utility Companies to develop) is that “the IRP be used to identify the timing and amount of resource requirements along with the preferred resource or resources.”

The Consumer Advocate continues to maintain that competitive bidding can be required in Hawaii without an extensive set of formal “guidelines.” However, in the event that the Commission is not persuaded that formal guidelines are unnecessary, the Consumer Advocate observes that a substantial record is available in this proceeding from which to construct an effective set of guidelines. In the interest of avoiding unnecessary delay, the Consumer Advocate provides a set of recommended guidelines in Appendix F1 to this document.

⁶ The HECO Companies appear to prefer guidelines from the Commission (see HECO Companies’ response to PUC-IR-24, at 1), again, with the details of implementation to be left to each utility, as discussed above).

The Consumer Advocate notes that its recommended guidelines are consistent with its prior recommendations to the Commission (see Section III. of the Consumer Advocate's Initial SOP). Moreover, in keeping with the HECO Companies' suggestion as set forth in their response to PUC-IR-27, the Consumer Advocate has fashioned its guidelines after the "major competitive bidding guidelines" adopted by the Oregon Public Utility Commission in Order No. 91-1383 (1991) (see the Executive Summary to that Order). The Consumer Advocate's guidelines also reflect other recommendations by the HECO Companies (see HECO Companies' response to PUC-IR-66, at 3, and the HECO Companies' response to CA-HECO-IR-11, which suggests that the Companies' specific recommendations on how to implement competitive bidding are quite limited).

Once again, the Consumer Advocate emphasizes that it does not see a set of formal "guidelines" as necessary. If the Commission determines that it is necessary to implement such guidelines, however, the Consumer Advocate recommends those contained in Appendix F1 as being sufficient to establish an effective foundation for requiring the conduct of a competitive bid process in Hawaii as a required mechanism to procure resources. After the Commission establishes competitive bidding as a requirement, if some party advances potential improvements to those guidelines, the Consumer Advocate would not object to the Commission initiating a proceeding to investigate the matter. However, the established competitive bidding framework should continue to be implemented until modified by the Commission.

C. THE HECO COMPANIES' RECOMMENDATION TO DELAY COMPETITIVE BIDDING UNTIL AFTER AN ADDITIONAL PROCEEDING HAS BEEN COMPLETED IS UNSUPPORTED AND NOT PERSUASIVE.

The Consumer Advocate finds troubling HECO's recommendation that a Commission requirement to use competitive bidding in Hawaii be delayed until after an additional proceeding has been conducted. Several matters merit the Commission's attention, as follows.

- First, the HECO Companies' assert that HECO has an "urgent need" for additional resources in order to address what appears to be immediate reliability problems for HECO (see HECO Companies' Initial SOP, Appendix A at 9). While it is not clear that resources from third-party developers might enable HECO to address its reliability problem more quickly, they might. Against this backdrop, the Consumer Advocate views the HECO Companies' recommendations to delay a Commission requirement to use competitive bidding as highly problematic.
- Second, and particularly in light of assertions regarding HECO's current urgent need for new resources, the HECO Companies' recommendation to delay a Commission requirement that competitive bidding be used is troubling relative to their statements indicating that there is a form of competitive bidding that "can be implemented quickly" (see HECO Companies' Initial SOP, Appendix A at 16). This particular approach appears to be very close to the approach that the Consumer Advocate favors, at least with respect to the discretion that would be afforded to Electric Utility Companies to design the RFP processes. The approach recommended by the Consumer Advocate in Section III. of its Initial Statement of Position appears very similar to the HECO Companies' recommendation, but for the suggested element of oversight by the Commission.
- Finally, the Consumer Advocate notes its concern regarding the HECO Companies' statement that they are "uncertain" as to: (1) whether competitive bidding should be implemented, (2) what form of competitive bidding, if any, to implement, and (3) when to apply the process (see the HECO Companies' response to PUC-IR-43, at 3). This uncertainty appears in sharp contrast to the considerable volume of information submitted in the HECO Companies' initial statement of position and subsequent information

request responses. The reason for their actions may lie in a strategy in this proceeding that appears to focus on preserving their ability to routinely pursue competitive bidding when it suits them. Delaying a Commission directive that a competitive process should be used to procure new resources effectively benefits HECO by preventing the new generating facilities that are currently being pursued from being subject to a competitive test. Indeed, HECO, in particular, seems committed to its plans to “sole source” (i.e., to itself) the next significant supply acquisition (see, e.g., the HECO Companies’ initial SOP, Appendix A at 8-9). While the resource selections ultimately might be justifiable, they should be addressed in public proceedings where options can be thoroughly examined.

The Commission should not transform this proceeding into one in which every detail of every possible type of competitive solicitation need be anticipated and resolved. Nor would it be appropriate (notwithstanding the HECO Companies admonitions to the contrary, see HECO Companies’ Initial SOP at 12), to launch the recommended “very time consuming” follow-up proceeding in which such details would be developed – while “urgent needs” go unaddressed. The case in favor of requiring competitive bidding is, at this juncture, quite straightforward:

- Competitive bidding can yield important benefits for Hawaii.
- The Electric Utility Companies now employ, and have experience conducting solicitation processes, and clearly have access to resources that will allow them to enhance RFP design and implementation processes.
- HECO apparently has an “urgent need” that might be addressed more quickly and cost-effectively through a competitive bidding process.
- The Commission can readily require the use of competitive bidding for new resource acquisitions through the actions identified in Section III. of the Consumer Advocate’s Initial Statement of Position.

As such, the Consumer Advocate continues to recommend that the Commission act quickly to require competitive bidding as the mechanism by which new capacity and

energy resources will be procured in Hawaii. The time is ripe for establishing a regulatory framework that will deliver to Hawaii the benefits of competitive bidding.

III. CLARIFICATIONS TO THE CONSUMER ADVOCATE'S INITIAL STATEMENT OF POSITION.

Based on its review of information requests issued by other parties in relation to its Initial Statement of Position, the Consumer Advocate observes that there may be aspects of that Initial Statement of Position that warrant further expansion and/or clarification. This Section of the Consumer Advocate's Final Statement of Position is intended to serve that purpose and address the following topics:

- "Best practices" in competitive bidding;
- Transparency;
- A utility's participation in its own solicitation;
- Cost recovery and ratemaking;
- DSM procurement recommendations; and
- Avoided Costs.

A. "BEST PRACTICES" IN COMPETITIVE BIDDING.

Included in the Consumer Advocate's Initial Statement of Position is the recommendation that the Commission make clear that electric utilities would be expected to adhere to "best practices" in the design and implementation of competitive bidding processes. The Consumer Advocate observes that a number of questions have been posed regarding what is intended, in concept, to be a straightforward recommendation. In response to such questions, the Consumer Advocate recommends

that the Commission view “best practices” in the same way that it views “good engineering practice” or “generally accepted accounting principles.” That is, it is entirely appropriate for the Commission to expect Electric Utility Companies to follow good engineering practice and apply generally accepted accounting principles for financial reporting purposes. This expectation exists even in the absence of Commission proceedings and Decisions and Orders that define in detail good engineering practices and generally accepted accounting principles. The Consumer Advocate observes that these terms invoke sets of standards and practices to which the Commission (and consumers) expect the Electric Utility Companies to adhere, even as they evolve over the course of time. The “best practices” that the Consumer Advocate recommends in this proceeding should be viewed in a similar context.⁷

The Consumer Advocate acknowledges that application of the adjective “best” to practices may create the impression that it seeks to hold the Electric Utility Companies to an extraordinarily high standard. This is not the case. In keeping with the often-used term “good engineering practice,” the Consumer Advocate ultimately suggests that the Electric Utility Companies use “good solicitation practices” in the design and implementation of their RFP processes. Perfection is not the goal. Rather the expectation is that reasonable efforts be made to identify and implement practices that will be effective in serving the interests of the utility and its ratepayers. Where two good approaches to a given problem are identified, the Consumer Advocate would

⁷ In practice, the utilities have a responsibility to serve customers reliably at the lowest reasonable cost. By following best practices, the utilities also can establish that they have met their franchise obligations.

recommend that the utility be granted a measure of discretion in selecting the one that it judges to be best suited to the task.

In this Section of its Final Statement of Position, the Consumer Advocate offers some further thoughts in an effort to clarify its recommendations for the implementation of “best practices.”

1. Clarifying the Definition Of “Best Practices.”

A paper published by the University of Dallas offers what the Consumer Advocate views as a reasonable, generic definition of “best practices.” It identifies best practices as:

documented, accessible, effective, appropriate, and widely accepted strategies, plans, tactics, processes, methodologies, activities, and approaches developed by knowledgeable bodies and carried out by adequately trained personnel which are in compliance with existing laws and regulations and that have been shown over time through research, evaluation, and practice to be effective at providing reasonable assurance of desired outcomes, and which are continually reviewed and improved upon as circumstances dictate.⁸

Useful insights can be extracted if this definition is analyzed from the standpoint of its component parts. The first part of the definition suggests that best practices can be readily identified. The definition states that best practices must be “documented and accessible,” e.g., to those who may have interest in replicating them. This is important in that it indicates the Commission reasonably can anticipate that utilities seeking to design and implement competitive bidding processes will be able to obtain information regarding best practices in the industry. Such information may come in the form of:

⁸ University of Dallas Center of Information Assurance “best practices” definition (see <http://gsmweb.udallas.edu>).

(1) reports and applications that have been submitted to other public utility commissions (and FERC) regarding the conduct of competitive bidding processes, (2) articles in trade journals describing particular experiences in competitive bidding processes; and (3) testimonies submitted by expert consultants in regulatory proceedings. Importantly, information of a similar nature also will be available to parties to each utility's competitive bidding solicitations, thus ensuring that practices introduced by a utility can be tested against the conventional wisdom.

The definition provides insight into why it is appropriate for the Commission and Electric Utility Companies to rely on best practices. The definition places emphasis on the fact that best practices are effective, appropriate, and widely accepted. This means that, where competitive bidding is concerned, the Commission should expect to identify a fairly broad base of support for practices that are viewed as being effective in achieving specific, desirable results.

The definition focuses on the activities that describe what constitutes "best practices." Here, the definition makes clear that best practices can encompass a broad set of "strategies, plans, tactics, processes, methodologies, activities, and approaches" that are "documented, accessible . . . widely accepted" for addressing a given situation. It is important to recognize that the processes by which competitive bidding occurs for supply- and demand-side resources are not simple ones. Benefits reside in the fact that best practices will emerge across the broad range of functions and activities that must be embraced by Hawaii's electric utilities if their competitive bidding programs are to be effective.

Next the definition indicates that the development of what constitutes best practices requires expertise in the field, in this case utility resource procurement. Certainly, there are utility personnel and consultants who have, over the course of the last quarter-century, acquired considerable expertise in competitive bidding. Some may reside in Hawaii and be employed by the electric utilities.⁹ Many others from outside of Hawaii's electric utilities would be available to support RFP design and implementation efforts. Such expertise can be brought to bear on competitive bidding processes in Hawaii, and can ensure that maximum benefits are achieved.

Next, the definition indicates that best practices must be in compliance with the existing laws and regulations. In addition best practices have been proven to be effective in providing reasonable assurance of achieving desired outcomes.

Finally, the definition anticipates that best practices are in a constant state of development by incorporating innovations and improvements that emerge through ongoing activity. The evolving nature of best practices makes it difficult to prescribe them in detail with the expectation that the stated practices today will be applied with certainty for any given future period of time. Moreover, best practices may vary with the specific resource needs. These factors would combine to make a Commission effort to prescribe best practices in the context of the instant proceeding particularly difficult. The result of such effort could be a set of "guidelines" (see PUC-IR-26(c)) with important

⁹ The Consumer Advocate discusses, in its Initial Statement of Position at 15, Hawaii's experience with competitive bidding.

elements that are at risk for obsolescence even as they are being adopted by the Commission in the instant proceeding.¹⁰

2. The Electric Utility Companies Are Fully Capable Of Identifying and Applying Best Practices in Competitive Bidding.

The Electric Utility Companies are fully capable of identifying and applying best practices in competitive bidding. In footnote 29 of its Initial Statement of Position, the Consumer Advocate offered a perspective on the term best practices. It states that:

best practices, as used here, is based on the fact that there is a substantial body of experience in the industry on methods of conducting competitive bidding for resources of various types. The utilities themselves have experience with competitive bidding. Moreover, they have access to the experience of others in the industry through discussions with utilities and consultants with experience in the bidding process to utilize bidding procedures that have been used to successfully conduct similar solicitations elsewhere.

HREA supports this view. It offers additional perspective regarding how a utility might engage best practices in the design and implementation of competitive bidding processes. As suggested in its response to PUC-IR-26, HREA states that “best practices” should be developed by the utility, based on its own experience, and after a review of recent experience on the mainland and solicitation of input from the PUC, IRP Advisory Groups, industry experts, and the ICA or Independent Evaluator. Both views are fully consistent with the definition advanced above. Both anticipate that Hawaii’s

¹⁰ Note, for example, the increasing use of the Internet as a tool for improving the timing and flow of communications between a host utility and bidders in a competitive bidding process has precipitated small, but important changes in best practices regarding RFP-related communications.

electric utilities are fully capable of identifying best practices in the design of competitive bidding processes and explaining their proposals relative to best practices.

3. Some Final Thoughts On Best Practices.

The comments in this proceeding raise questions regarding the application of best practices in competitive bidding. The HECO Companies appear to expect Commission approval of the costs that will be incurred to pursue competitive procurements, but resist the recommendation to apply the best practices standard (see, e.g., HECO Companies' responses to PUC-IR-25 and PUC-IR-75). The HECO Companies also makes clear their desire for flexibility in the design and implementation of the competitive bidding solicitation. Indeed, the HECO Companies state that each utility should be able to design its own RFP, evaluation criteria, evaluation process, etc. (see HECO Companies' response to PUC-IR-31). The Consumer Advocate likewise contends that the utilities must be responsible for designing solicitation processes that are appropriate to their particular needs and circumstances.

Those who resist the application of best practices beg two questions:

1. If not best practices, then to what standards should the Electric Utility Companies design and implement competitive bidding processes?
2. Should the Electric Utility Companies be free to design and implement solicitation processes absent Commission oversight?

In answering the first, the Consumer Advocate suggests that consumers deserve, and prudent action requires the Electric Utility Companies to apply best practices to these important functions. In answering the second, the Consumer Advocate maintains that self-dealing concerns and ratepayer interests (given both the

reliability and cost implications of utility procurement decisions) are so great that the Commission must remain involved.

In recommending best practices, the Consumer Advocate offers both guidance for constructing, and a standard for reviewing competitive bid solicitations. By contrast, while the HECO Companies appear to resist the application of best practices, they offer no alternative (although the Consumer Advocate does not anticipate that they will recommend “worst practices”). The essential difference between the parties appears to lie in the fact that the Consumer Advocate offers a necessary and effective standard by which the Commission can judge the effectiveness of utility RFP design and implementation efforts. This does not constitute “Monday morning quarterbacking” (see the HECO Companies’ Response to PUC-IR-25); rather the Consumer Advocate offers a reasonable approach by which the Commission can provide, prospectively, the significant parameters under which competitive bidding will be used to procure resources.

B. TRANSPARENCY.

The following discussion is intended to augment the presentation on “transparency” that was provided in the Consumer Advocate’s Initial Statement of Position. The Consumer Advocate adheres to the view that transparency in resource procurement processes is critical. Here, the Consumer Advocate offers further information regarding what constitutes transparency and why it is important to competitive bidding processes.

1. What constitutes “Transparency.”

Webster’s Dictionary indicates that transparent can mean “easily seen through” and “easily understood.” The Consumer Advocate observes that there are several aspects in which competitive bidding processes should be transparent if they are to benefit the public interest.

First, competitive bidding processes should be transparent in the sense that all participants (and affected stakeholders) should have a clear view of the objectives of an RFP and the procedures by which the RFP will be conducted. This means that a host utility must strive to ensure that its announcements, RFP documentation, and other communications regarding a solicitation process must be effective in communicating the sequence of steps by which solicitation processes will be conducted.¹¹ Collaboration in RFP design processes (e.g., with IRP stakeholders) can be expected to considerably improve the transparency of the RFP process. In such case, the collaboration should be well-publicized and open.

Second, all participants (and affected stakeholders) should have a clear view of how the winning bidder will be selected. As HECO puts it, bidders want to know “How can I win the bid?” The host utility must be effective in communicating essential information regarding how bids will be evaluated. Transparency might be enhanced if

¹¹ Appendix 1 to the Consumer Advocate’s Initial Statement of Position offers an example of the type of document that a utility can issue to potential bidders and other stakeholders, in order to communicate basic information on its approach to competitive bidding.

bid selection processes are made fully visible to all bidders.¹² However, the Consumer Advocate anticipates that this will not always be feasible (limitations will arise in the form of confidentiality requirements, the exercise of judgment among decision-makers, the need for candid negotiations between the host utility and short-listed bidders, etc.).

If transparency objectives conflict with confidentiality requirements, or impinge upon effective decision processes, a balance must be struck using best practices as a guide. Transparency should not be pursued to the point of unduly compromising confidentiality or effective decision processes. Where decisions are to be made behind closed doors, however, transparency requires that participants in an RFP be provided as much information as is reasonably possible regarding the nature of the information that will “enter” the closed-door session, how that information will be used, and the foreseeable results. For example, RFP documentation could prescribe the bid evaluation process as including, but not be limited to the following: (1) the specific information that will be provided to the “bid selection committee,” (2) the factors that they will be instructed to consider (and not consider) as they evaluate bids, (3) the sequence of analyses and decisions to be made, (4) the degree to which elements of the decision will be purely factual versus where, and to what degree judgment will be allowed to enter the process, (5) the nature of the results that will be released by the bid selection committee, etc.

¹² Evaluation processes have been conducted by which representatives of bidders (or their agents) have been allowed to observe the process in which bids were selected, having first signed confidentiality agreements prohibiting them from divulging confidential information. The Consumer Advocate is not advocating this practice, but identifies it as an example of one approach to making more transparent a process that might otherwise be “opaque” to bidders (i.e., as a selection committee makes its “behind-closed-doors” decisions).

Third, all participants should have ready access to all relevant information, such that no participant has any advantage in terms of the information made available by the host utility. FERC defines transparency as “the free flow of information to all parties”¹³ in concluding that all relevant information about an RFP should be released to all potential bidders at the same time. Transparency in the flow of information ensures that no potential RFP participant is deliberately or inadvertently denied information.

2. Why is having “Transparency” important to an effective competitive bid process.

Without strict attention to transparency, significant problems can arise that can undermine competitive bidding processes. Bidders can be discouraged from participating in the solicitation, thereby diminishing the range of options available – and potentially increasing consumer costs. As is suggested by FERC, discriminatory practices can arise in fact, or in appearance, which can lead to more litigious proceedings (and, again, greater costs). FERC also states that instances of actual discrimination may be undetectable in a non-transparent market.¹⁴

While a “transparency” requirement almost certainly would fall within the domain of “best practices,” a separate emphasis is warranted here. Ensuring both fairness and a healthy response to an RFP issued by a utility will depend on ensuring that, in both fact and appearance, a fair and level playing field is developed and implemented in evaluating bids. Put succinctly, the best way to achieve this objective is to ensure that:

¹³ 108 FERC ¶ 61,081, page 4.

¹⁴ 89 FERC ¶ 61,285, page 36.

(1) the bid evaluation processes are understood by bidders and other external parties, and (2) the role of the utility and its affiliates as a participant in the bidding process is clear to all and at arms length from the evaluation of the bids.

C. A UTILITY'S PARTICIPATION IN ITS OWN SOLICITATION.

The Consumer Advocate is concerned that there may be some confusion regarding its recommendations in Section III.H. of its Initial Statement of Position regarding a utility's role in its own solicitation processes. This section is intended to clarify those recommendations.

1. The Model.

The tenets of the Consumer Advocate's position regarding participation by a utility in its own competitive solicitation (or more accurately, in response to a need that it has identified) are as follows:

- There are two sets of circumstances under which a utility might initiate competitive bidding processes:
 - ◆ Reliability-based: In which the utility solicits capacity resources to address an imminent need in order to maintain established reliability standards, in fulfillment of its obligation to serve. That is, some RFPs can be expected to occur when additional resources are needed to ensure that: (1) the utility maintains an adequate generating capacity to meet foreseeable customer demands and to address system operating requirements in accordance with established reliability standards, or (2) the utility's resource mix has sufficient fuel diversity so as to not be at risk for reliability problems because of foreseeable shortages, or other restrictions on fuel supplies. (Note that such needs also may be motivated by fuel supply concerns.)

- ◆ Non-reliability-based: In which the fundamental purpose of the solicitation is to:
 - Meet some exogenous requirement, such as one that is imposed by the Legislature (e.g., a renewable portfolio standard (“RPS”)) or a public agency (e.g., the Commission), or
 - Achieve any “discretionary” improvement in system performance, such as a voluntary reduction in greenhouse gas emissions.
- Where a solicitation is reliability-based, a utility must identify a facility (i.e., a “self-build” proposal) that is responsive to the identified need and represents its best response to that need (i.e., in terms of foreseeable costs and other characteristics).
- Where the utility seeks to advance its project (i.e., over those of other developers), its proposal:
 - ◆ Must be well-developed.
 - ◆ Must be cost-based.
 - ◆ Must identify a cap on cost-recovery to the proposal set forth in the bid offering.
 - ◆ Must anticipate ratebase treatment of costs.
 - ◆ Must be capable of implementation. (e.g., permits must not be an insurmountable hurdle, resource technology must be proven, etc.)
 - ◆ Must be held to the same contractual standards as would apply to projects advanced by other bidders (such as minimum availability requirements), whereby failure to meet such standards will affect the utility’s earned returns in the same way that it would affect a winning bidder’s earned returns, similar to financial penalty provisions that are set forth in purchase power contracts.
- Where the utility does not seek to advance its project (i.e., over those of other developers), the utility:
 - ◆ Must demonstrate that there is reason to believe that relying on the market to provide the needed resource is prudent.

- ◆ Must develop a “backstop” proposal to a degree consistent with prudent planning, such that the utility is able to respond in a reasonable timeframe if the competitive bidding process unexpectedly fails to produce a viable project proposal. In this regard the utility must frame a backstop proposal that is capable of being implemented, to the extent foreseeable after an appropriate amount of planning.
 - ◆ Must anticipate cost-based treatment of its backstop proposal with the expectation that the cost of such proposal will be reflected in the utility’s ratebase.
 - ◆ Must be held to the same contractual standards as those applied to projects advanced by other bidders (such as minimum availability requirements), whereby failure to meet such standards will affect the utility’s earned returns in the same way that it would affect a winning bidder’s earned returns.
- Where the solicitation has as its focus something other than reliability, the utility may choose (or decline) to advance its own project proposal (either in the form of a bid or a backstop). If the utility chooses to advance its own proposal, the provisions of Part 2.a., above, would apply.
 - A utility shall not be allowed to advance multiple projects to address a given need (i.e., mutually exclusive projects, such as if the utility submitted two, separate proposals for 50 MW facilities in response to an identified 50 MW need).
 - A utility affiliate may participate in any competitive solicitation, provided that proper safeguards are in place to ensure the “arm’s length” evaluation of such solicitation. This may require that a third party either administer or closely monitor the solicitation process.

The above sets a foundation for the Consumer Advocate’s position regarding the role that a utility would play in its own solicitation processes. The rationale for that position is set forth below, beginning with the rationale for competitive bidding itself.

2. Discussion of the Circumstances in Which Utility Participation May Be Required .

The following discussion is intended to offer additional insight into the above model and the Consumer Advocate's view on how best to frame a utility's role in its own competitive solicitation processes. As stated in the preceding section of this Statement of Position, there are essentially two categories of competitive bidding processes that can be conducted by a utility. The first is solicitations of resources to address an imminent reliability need. The second is to solicit resources that a utility might require for reasons other than preserving system reliability. These two categories of solicitations, which the Consumer Advocate broadly describes as "reliability-based" and "not reliability based," serve as the points of departure in the following discussion.

The term "participate," as used by the Consumer Advocate, refers to any time a utility develops a "self-build" project proposal in response to its own resource need (i.e., if the utility is planning to advance its project and compete directly with the project proposals of other bidders in response to an RFP). The term "participate" also applies where a utility identifies a "backstop" proposal that it is not seeking to advance. Such a backstop proposal, depending on circumstances, may be less developed in terms of the engineering design work and cost analysis, depending on the circumstances (as is discussed in greater detail below).

Among the most basic responsibilities of the Electric Utility Companies is to ensure a reliable supply of electricity. Where competitive bidding processes are conducted to respond to an identified need, the failure of a solicitation process cannot be accepted as a final result. That is, a utility cannot allow a reliability shortage to develop and persist simply because its efforts to conduct a fair, competitive RFP failed

to produce a viable project. Rather, the utility must take reasonable action, in keeping with its obligation to serve, to respond to such failure. The Consumer Advocate recommends that a “backstop” proposal from the utility would be a necessary response to supplement any competitive bidding process in which system reliability is at stake.¹⁵

A backstop proposal will, however, present challenging questions regarding how well-developed the proposal must be to represent a reasonable and prudent response to the risk that an RFP may fail to yield a viable project. Clearly there will be competitive bidding processes where the host utility will have a high degree of confidence in the result. In such circumstances, sinking considerable resources into defining the engineering and cost requirements of a backstop project may be unwarranted. Alternately, some non-reliability-based RFPs may be exploratory in nature because a utility, for example, may want to “test the market” to see if the market will offer a resource that might cost-effectively meet the utility’s identified needs. To the extent that there is doubt regarding the likely result of the solicitation, a well-developed backstop proposal may be in order. A number of factors including the nature of the need, the magnitude of the need, the anticipated market response, etc., could affect the decision. Also important might be the period of time that remains before the need will materialize. There may be circumstances under which the passage of time (and events) would dictate that further refinement of a backstop proposal should be done.

¹⁵ Note that, if a utility chooses to advance its own project proposal through the competitive bidding process, that proposal (presumably a viable proposal) would establish the “backstop” in the event that the RFP did not otherwise identify a third-party supplier as winner.

Ultimately, judgment will be required in determining how far to take a backstop proposal at any given point in time.^{16,17}

Where a competitive bidding process is not reliability-based, the situation is quite different. Under such circumstances, the Consumer Advocate contends that it would be reasonable for a utility to choose not to advance any backstop proposal (or any other project proposal) to address its identified need.¹⁸ Some attention is warranted, however, to the circumstances in which a utility would be allowed the option of submitting a project proposal in response to its own need. Experience shows that, from time to time, competitive bidding processes may fail to yield viable projects. Such failure may come in different forms, including: (1) insufficient interest in a particular solicitation and a consequent lack of quality, reasonably-priced proposals, (2) an inability to achieve a contractual agreement with a winning bidder, and/or (3) a winning bidder's inability to achieve critical project development milestones, etc. The failure of a competitive bidding process is always a risk, to at least some degree.

Finally, the Consumer Advocate recommends that a utility's participation in its own competitive bidding processes not extend to proposing multiple (i.e., mutually exclusive) projects in response to an identified need. If a utility advances more than

¹⁶ A backstop proposal must be capable of implementation (i.e., viable), if it is to be an effective response to a failed RFP. The Consumer Advocate recognizes however, that a project's viability may be difficult to establish, particularly during early stages of project development. Nonetheless, the utility should be expected to advance a backstop project in which it has reasonable expectation of viability, at early stages of development and thereafter.

¹⁷ The Consumer Advocate notes that, as a general matter, backstop proposal development costs should be recoverable through rates.

¹⁸ Nonetheless, the Consumer Advocate would strongly encourage utilities not to ignore potential "self-build" projects that would bring low-cost supplies to consumers.

one proposal, backstop or otherwise, a range of problems can result. First, developing resource proposals requires an investment of time, money, and intellectual capital. The Consumer Advocate contends that a utility should minimize costs by focusing on single project proposal that represents its best offering. Second, the existence of two (or more) utility proposals appears to open the door to “gaming.” For example, a utility might keep its best proposal “in reserve” as a backstop, which would be advanced after the RFP has run its course (and with the benefit of competitive knowledge obtained through the RFP). Third, if more than one project is advanced, at least one will be “suboptimal” (i.e., relative to the utility’s true needs). Ratepayers should not be asked to support the costs of the suboptimal project proposal (i.e., a suboptimal project should never “win”), nor should the Commission be assigned the task of having to cull out the suboptimal project(s) from a set of two or more utility proposals. Rather, the utility should be expected to put forth only a single, “best” response to an identified need. Again, this applies whether the utility participates directly or indirectly in its competitive bidding process.¹⁹

¹⁹ The HECO companies state in their response to PUC-IR-33, at 1, that “HECO’s preferred contingency plan may be different depending on the timing of IPP project failure.” The Consumer Advocate acknowledges that, depending on the circumstances, modifications to a backstop proposal (i.e., as initially cast) may be appropriate and/or unavoidable. However, the Commission’s expectation must be that a utility will identify its preferred, final backstop proposal (even if it is still in a rudimentary form) from the start of each solicitation process, and to the extent feasible given specific circumstances. To do otherwise will create opportunities for the utility to “game” the solicitation process (e.g., to wait until just after bids are received to fashion a proposal that can edge out bids received relative to established evaluation criteria).

3. Potential Problems With Utility Participation.

This Section briefly addresses the potential problems that can arise if a utility participates in its own competitive bidding process, and the Consumer Advocate's related recommendations. The Consumer Advocate anticipates that a utility may wish to advance a self-build project proposal in its own RFP whether the solicitation is to address a reliability-based or not reliability-based need. Such action may be an effort to be consistent with its corporate financial objectives, or because the utility believes that it can develop a project proposal that would better respond to its resource needs than those of third-party developers. For example, a utility may anticipate that it has access to a generating site or other input resources that would allow it to advance a project proposal that is lower cost than the likely project proposals of potential bidders.

An electric utility company should be allowed to advance its own proposal. However, because a host utility would design and implement its own RFP processes the utility often is perceived as seeking to bias the results in favor of its resource proposal, whether or not it has such intent (and whether or not it chooses to directly participate in its competitive solicitations). Participation by an affiliate of the utility also raises the same concern. "Self-dealing" by the utility is a threat to potential bidders because of the utility's unique position to influence the results of any competitive bidding process. It can diminish potential bidders' interest in participating in competitive bidding processes, and can lead to disputes as such processes proceed.

The Consumer Advocate asserts that when a utility participates, directly or indirectly through its affiliate, in its own solicitation process, strong affirmative steps must be taken by the utility in RFP design and administration processes (in keeping with

best practices) to avoid even the perception that self-dealing might occur and to ensure that the competitive bidding process remains fair and unbiased. Section III.H. of the Consumer Advocate's Initial Statement of Position contains a number of recommendations that focus on the mitigation measures intended to address the self-dealing concerns that arise when a utility participates in its own solicitation process.

In summary, utility and/or its affiliate participation in a competitive solicitation must occur in a visible manner. That is, the utility and/or its affiliate should be required to submit its proposal along with those of other bidders, subject to the same solicitation rules and procedures (i.e., to the extent feasible) as other bidders. To do otherwise would set the stage for a utility to usurp its solicitation process by presenting its proposal after the RFP has run its course and after it has had opportunity to "tune" that proposal based on knowledge gained through the RFP. Even the possibility of such a result will undermine the solicitation processes; thus, the utility must participate as a bidder whenever it chooses to advance a project proposal in response to an identified need.²⁰

D. COST RECOVERY AND RATEMAKING.

The recovery of costs incurred by utilities in competitive bidding processes presents a number of important issues. In this Section, the Consumer Advocate

²⁰ Note also that requiring a utility to submit a bid if it chooses to advance a project in its own RFP will ensure (among other things) that a utility's proposal is well-developed and viable (e.g., rather than merely an outline of what it might do at an asserted price that is very cost-competitive). Such approach will ensure that, if the utility wants to pursue a self-build project, that project will receive a meaningful test relative to market alternatives. By contrast, if the utility's proposal is permitted to undergo a review process that differs from that applied to other bidders, preferential treatment becomes a serious risk.

amends its position regarding the costs that would be eligible for rate recovery and related matters.

When a utility develops a proposal in fulfillment of its service obligations, either as a bid or backstop proposal, the utility must endeavor to identify all costs of that resource. This is particularly true of cost estimates for a resource that the utility actively is seeking to advance (i.e., through bid processes). Without such information, effective decisions regarding resource options cannot be made. As is stated above in the Consumer Advocate's Model for utility participation in competitive bidding, cost-based ratemaking should apply to utility project proposals. This is consistent with the historic treatment of utility resource proposals. The Consumer Advocate anticipates that the costs of any self-build generation option that ultimately is developed and put into commercial operation would be incorporated into ratebase.

When bidding in its own solicitation process, the utility should identify a cost cap that would set an upper limit for ratemaking purposes. This limitation is necessary to ensure that a utility does not gain an advantage over other bidders in its solicitation processes by routinely bidding "low," with the expectation that approved rates will incorporate any cost overruns that occur relative to that bid price. Ensuring a level playing field requires that the utility be held to the same expectations regarding its bid prices, as would other RFP participants.²¹ Moreover, the Consumer Advocate recommends that, whether the utility participates directly, or indirectly in its solicitation,

²¹ The Consumer Advocate is not aware of any RFPs that have allowed bidders to submit "cost-plus" proposals, whereby a successful bidder would be ensured that its costs would be contractually-recoverable and that it would enjoy a level of profitability, regardless of the level of costs incurred.

the utility's proposal should be held to the same "price" and "non-price" contract terms as would apply to all bidders. As with price bids, to allow utilities flexibility not afforded to other participants in RFP processes would be to grant the utility an implicit advantage.

As noted above, the costs that a utility reasonably and prudently incurs in developing a backstop proposal should be recoverable through rates. In addition, the Consumer Advocate recommends that the costs a utility reasonably and prudently incurs in designing and administering its competitive bidding processes should be recoverable through rates. Both are legitimate costs that would be incurred by a utility in fulfillment of its service obligations.

Finally, in its Initial Statement of Position, the Consumer Advocate suggested incentives to promote the implementation of effective competitive bidding processes. In its response to PUC-IR-77, HECO suggests that it is "too preliminary to speculate on possible adjustments to Rate Base." The Consumer Advocate agrees that any such ratemaking incentives need not be explored in this docket, but rather can be explored in later proceedings addressing utility rates (e.g., future rate cases).

E. DSM PROCUREMENT RECOMMENDATIONS.

In this Section, the Consumer Advocate seeks to clarify its recommendations regarding the procurement of demand-side resources. It also offers a brief reaction to statements made by the HECO Companies related to the scope of competitive bidding processes.

1. Clarifications.

The Consumer Advocate seeks to eliminate any remaining confusion regarding its recommendations for the scope of competitive bidding, particularly as would relate to demand-side resources. The Consumer Advocate recognizes that some states implemented what sometimes are referred to as “all source” solicitations, in which supply- and demand-side resources were eligible to compete for a need identified through a single RFP. Some apply the term “all source” to processes in which separate RFPs seeking resources of different types are issued to address a specified utility need.

The Consumer Advocate can envision that there may be occasional circumstances under which demand-side resources: (1) might not be part of an optimal resource procurement package, or (2) might best be procured outside of any competitive bidding process. However, the Consumer Advocate anticipates that the circumstances that justify such action would appear so infrequently that it would seem prudent to presume that DSM: (1) would be an integral part of any response to utility resource needs, and (2) should be procured through competitive bidding.

Accordingly, the Consumer Advocate recommends that competitive bidding processes routinely should be open to demand-side resources, unless a party is able to demonstrate that demand-side resources should not be procured through an RFP in response to an identified need. When demand-side resources are to be procured through an RFP, the issue reduces to whether a single, or multiple RFPs would best be issued. The Consumer Advocate does not have a preference here. Rather, the matter should be left to each utility to design solicitation processes that suits its circumstances.

2. Competitive Bidding Should Apply to All Electric Utility Resources.

In their initial statement of position and responses to information requests, the HECO Companies indicate that competitive bidding should be limited to solicitations for what in Hawaii essentially would be large, central station generating facilities (see, e.g., ECO Companies' response to PUC-IR-40(b)). In addition, they state that "the bid process for new generation should not apply to DSM, and a separate competitive procurement process should be applied in the case of utility-owned CHP systems (HECO Companies' Initial SOP at 11). The HECO Companies recommend that the RFP process be open to only supply-side resources, with DSM options not eligible to bid, and with combined heat and power projects acquired through a competitive procurement process (HECO Companies' Initial SOP, Appendix A at 26).

As noted above, the Consumer Advocate's Initial Statement of Position suggests that competitive bidding should apply to all electric utility resource requirements, unless strong reason exists for doing otherwise. The Consumer Advocate contends that a strong case can be made for extending competitive bidding to a broad range of resource requirements.

3. DSM.

The HECO Companies argue that competitive bidding processes for DSM resources should be addressed outside of the context of the competitive bidding processes for new generation. The HECO Companies assert that demand-side resources are very different from traditional supply-side resources, and that past efforts to evaluate demand-and supply resources using the same evaluation criteria proved to

be flawed (HECO Companies' Initial SOP, Appendix A at 26). The HECO Companies claim that the industry standard since the late 1990's has been to conduct only supply-side solicitations, and that "DSM RFPs have not been common recently" (HECO Companies' Initial SOP, Appendix A at 26).

The Consumer Advocate continues to recommend that demand-side measures should be acquired through competitive bidding processes. Information presented to the Commission in earlier phases of this proceeding demonstrates that demand-side resources can be solicited through RFPs to which supply-side bidders are expected to respond (see, e.g., Consumer Advocate's Initial Statement of Position, Appendix 1, at 9). Separate, solicitations conducted in parallel to those seeking supply-side resources also are an option. The Consumer Advocate's Initial Statement of Position accepts that there may be times when DSM resources should be solicited through the same RFP as supply resources, but also times when a separate solicitation would be warranted.

The Consumer Advocate continues to recommend that the competitive solicitation establish the standard for the mechanisms by which supply- and demand-side resources are to be procured. DSM measures are resources for which vibrant competitive markets (in the form of third-party vendors offering a complex array of conservation and demand reduction measures) exist in Hawaii and across the country. Hawaii's utilities typically make substantial investments in these resources. Innovation in program design and implementation occurs with some frequency and is to be highly valued. Moreover, because of the substantial non-price benefits that can be achieved through demand-side measures, some form of "head to head" competition between

DSM and supply-side solutions to any resource need often is desirable – even if the demand-side measures ultimately can address only a portion of a utility's total incremental need.

Furthermore, the Consumer Advocate rejects the HECO Companies' unsupported suggestion that RFPs for demand-side resources are a thing of the past. The Consumer Advocate observes that RFPs for demand-side resources continue to occur. Earlier this month the Puget Sound Energy Company filed a demand-side RFP with the Washington Utilities and Transportation Commission that, according to a Business Wire report, "seeks to broaden and expand the utility's already ambitious menu of energy-efficiency services for its customers." Puget Sound expects to issue the RFP on November 1, 2005. In addition, in February of 2005, the Public Service Company of Colorado issued an RFP for demand-side resources that was one of three RFPs issued in an "all-source" competitive bid solicitation. PacifiCorp also has announced its intention to issue a DSM RFP this summer. The GAP RFP issued by ISO New England (as cited in the Consumer Advocate's Initial Statement of Position) is another example of competitive bidding for demand-side resources. Clearly, there is continued interest in competitive bidding as an effective and efficient means to procure demand-side resources. The fact that many public utility commissions may have shifted their focus to industry restructuring in recent years should not be viewed as a move away from competitive bidding for demand-side resources.

4. Combined Heat and Power Facilities.

The HECO Companies state that for Combined Heat and Power (“CPH”) resources, they plan to use “a competitive procurement process” whose objectives would include: (1) ensuring the provision of quality CHP products and services, (2) standardizing equipment and designs, (3) achieving efficiency in the equipment selection process, and (4) obtaining cost savings for the utility and its ratepayers over the life cycle of the CHP installation (HECO Companies’ Initial Statement of Position, Exhibit A at 27). By their statements, the Companies appear to be indicating that CHP resources will be procured through processes that are significantly different from the competitive solicitations by which other resources might be procured (see HECO Companies’ Initial SOP at 3).

The Consumer Advocate commends the HECO Companies for embracing competitive procurement as their anticipated mechanism for procuring CHP resources. However, the Consumer Advocate recommends the following, as would apply to both CPH resources and distributed generation (“DG”) more broadly. First, the installation of CHP and other distributed resources should be accommodated to the extent feasible whenever a utility considers potential responses to an identified resource need. Second, when a utility takes steps to acquire additional CHP resources, as with other

procurements, competitive bidding should be the default approach.²² As indicated in the Consumer Advocate's Statement of Position (at 22) in Docket No. 03-0371:

If DG is developed by the electric utility company or by a third party (not the customer site) and the generating output is intended to be sold to the electric utility for resale to retail customers, DG projects should be measured or compared to other generating projects through a competitive bidding process. If a customer installs DG for its use first, then the customer makes its own economic decision by comparing the cost of the DG facility to the unbundled rates that would be implemented in conjunction with DG.

The Consumer Advocate accepts that a party to a utility's resource procurement proceeding may be able to demonstrate that some other form of competitive procurement might better suit a particular resource need (i.e., where CHP or other DG resources appear desirable). However, benefits can be achieved through competitive bidding processes that are open to the full range of providers and the innovations that they can bring. Thus, the Consumer Advocate recommends that competitive solicitations accommodate a broad range of resource options, unless clear reasons for doing otherwise are presented.

F. AVOIDED COSTS.

The nature of a utility's response to its identified needs has a bearing on its avoided costs. Although not central to its recommendations regarding the implementation of competitive bidding in Hawaii, in its Initial Statement of Position

²²

The Consumer Advocate believes that competitive bidding for distributed generation resources can be achieved without the introduction of formal rules and regulations. The Consumer Advocate also contends that there should be no restrictions on who could own and operate DG projects (see the Initial Testimony, at 69, submitted on behalf of the Consumer Advocate in Docket No. 03-0371). However, the Consumer Advocate agrees with the position that, for safety and security reasons, DG installed inside a utility's substation fence should only be owned and operated by the utility (see the Rebuttal Testimony, at 15, submitted on behalf of the Consumer Advocate in Docket No. 03-0371).

(at 50) the Consumer Advocate offered several suggestions regarding the calculation of avoided costs. The following discussion is intended to clarify those suggestions. The Consumer Advocate's position is as follows:

- When an Electric Utility Company: (1) has a need for additional capacity and energy resources, and (2) is conducting an RFP to resolve that need, the PURPA facility should be expected to participate in that RFP. There, the winning bid effectively would establish the utility's avoided costs.
- When an Electric Utility Company has no need for additional capacity, its avoided costs should reflect avoided energy costs only.
- When an Electric Utility Company: (1) has a need for additional capacity and energy resources, but (2) is not yet developing or conducting an RFP to resolve that need, the Consumer Advocate recommends that that resources readily available through competitive power markets not be ignored in determining a utility's avoided costs. Rather, in considering such resource proposals that come to it outside of a formal solicitation process, the Consumer Advocate recommends that a utility's avoided costs should reflect lower of: (1) typical procurement costs from that market, or (2) its reasonably foreseeable "self-build" costs.

The essence of the Consumer Advocate's position is that, where competitive markets offer ready access to needed resources at cost-effective prices, the Commission's method for calculating avoided costs should not presume that such opportunity is not available. To do otherwise will expose consumers to prices for high-priced resources that could be avoided.

IV. SUMMARY CONCLUSION.

Competitive bidding should be required by the Commission as the primary mechanism for the acquisition of new capacity and energy resources by Hawaii's electric utilities. There is broad agreement among the parties that competitive bidding

can bring important benefits to Hawaii. The Electric Utility Companies are experienced in, and are fully capable of conducting competitive solicitations. Competitive bidding can be required and implemented with very little, by way of additional, regulatory process. In summary, there is no reason to delay the requirement that competitive bidding be used as a mechanism to procure resources and delay the realization of the benefits that can be offered Hawaii's electric consumers.

DATED: Honolulu, Hawaii, August 11, 2005.

Respectfully submitted,

By Cheryl S. Kikuto
for JOHN E. COLE
Executive Director

DIVISION OF CONSUMER ADVOCACY

APPENDIX F1

CONSUMER ADVOCATE'S RECOMMENDED COMPETITIVE BIDDING GUIDELINES

General Guidelines:

1. Competitive bidding shall be the presumptive, "default" mechanism by which new resources shall be procured to meet the needs of Hawaii's electric utilities for new power supplies and demand-side resources.¹
2. Competitive bidding is an integral part of the Commission's integrated resource planning ("IRP") framework.²
3. Subject to Commission oversight, each utility will be responsible for RFP design, RFP implementation, bid evaluation, and contracting with winning bidders.³
4. Each utility will design and implement its competitive bidding processes in keeping with "best practices" in the electric utility industry.⁴

RFP Design:

5. Creating solicitation documents that allow all resources – supply - and demand-side – to compete for an identified resource need is a basic objective.⁵

¹ See Consumer Advocate's Initial Statement of Position at 45; Response to CA-PUC-IR-24; Consumer Advocate's Final Statement of Position at 4.

² See Consumer Advocate's Initial Statement of Position at 45-46, Consumer Advocate's Final Statement of Position at 4.

³ See Consumer Advocate's Initial Statement of Position at 55, Consumer Advocate's Final Statement of Position at 5, 9.

⁴ See Consumer Advocate's Initial Statement of Position at 43-44, 55-57, Consumer Advocate's Final Statement of Position at 9, 17-24.

⁵ See Consumer Advocate's Initial Statement of Position at 3, 45, Consumer Advocate's Final Statement of Position at 38-42.

6. A commercial contract is the expected result of the competitive bidding processes. A proposed contract should be included with each RFP.⁶
7. An independent advisor may assist the solicitation design process.⁷

RFP Implementation:

8. Each utility shall take steps to encourage participation from the full range of prospective bidders. PURPA QFs, IPPs, utility-affiliates and other utilities should not be unduly restricted from participation in any supply-side RFP.⁸
9. Bid evaluation should include both price and non-price factors (e.g., dispatch ability, availability, environmental impacts).⁹
10. The utility shall summarize solicitation results in a report to the Commission.¹⁰
11. An independent entity may assist the solicitation implementation and evaluation process.¹¹

Participation by the Host Utility:

12. Where system reliability is at stake, the utility must develop a “backup” project proposal that is responsive to the identified need

⁶ See Consumer Advocate's Initial Statement of Position at 56, Consumer Advocate's.

⁷ See Consumer Advocate's Initial Statement of Position at 57; Response to CA-PUC-IR-38; Consumer Advocate's Final Statement of Position at 19-21.

⁸ See Consumer Advocate's Initial Statement of Position at 3, 24-25, 45; Response to CA-PUC-IR-71; Consumer Advocate's Final Statement of Position at 38-42.

⁹ See Consumer Advocate's Initial Statement of Position at 20, 59; Response to CA-PUC-IR-2; Consumer Advocate's Final Statement of Position at 37-38.

¹⁰ See Consumer Advocate's Initial Statement of Position at 49; Response to CA-PUC-IR-45, 68.

¹¹ See Consumer Advocate's Initial Statement of Position at 49; Response to CA-PUC-IR-68.

and represents the best (“self-build”) response to that need in terms of foreseeable costs and other characteristics.¹²

13. Where the utility seeks to advance its project (i.e., over those of other developers), the proposal:
 - a. Must be well-developed.
 - b. Must be cost-based.
 - c. Must identify a cap on cost-recovery to the proposal set forth in its bid offering.
 - d. Must anticipate ratebase treatment of costs.
 - e. Must be capable of implementation.
 - f. Must be held to the same contractual standards as would be projects advanced by other bidders (such as minimum availability requirements), whereby failure to meet such standards will affect the utility’s earned returns in the same way that it would affect a winning bidder’s earned returns.¹³

14. Where the utility does not to seek to advance its project (i.e., over those of other developers), the utility:
 - a. Must demonstrate that there is reason to believe that relying on the market to provide the needed resource is prudent.
 - b. Must develop a “backstop” proposal to a degree consistent with prudent planning, such that the utility is able to respond in a reasonable timeframe if the competitive bidding process unexpectedly fails to produce a viable project proposal. In this regard, the utility must frame a backstop proposal that is capable of being implemented, to the extent foreseeable after an appropriate amount of planning.

¹² See Consumer Advocate’s Initial Statement of Position at 52, 60, Consumer Advocate’s Final Statement of Position at 31-34.

¹³ See Consumer Advocate’s Initial Statement of Position at 59-60; Consumer Advocate’s Final Statement of Position at 35-36.

- c. Must anticipate cost-based treatment of its backstop proposal with expectation that the cost of such proposal will be reflected in the utility's ratebase.
 - d. Must be held to the same contractual standards as would be projects advanced by other bidders (such as minimum availability requirements), whereby failure to meet such standards will affect the utility's earned returns in the same way that it would affect a winning bidder's earned returns.¹⁴
15. Where the solicitation has as its focus something other than a reliability need, the utility may choose (or decline) to advance its own project proposal (either in the form of a bid or a backstop). If the utility chooses to advance its own proposal, the subparts of Part 14, above, would apply.¹⁵
 16. A utility shall not be allowed to advance multiple (i.e., mutually exclusive) projects in response to an identified need.¹⁶
 17. A utility affiliate may participate in any competitive solicitation, provided that proper safeguards are in place. This may require that a third party either administer or closely monitor the solicitation process.¹⁷

Role of the Commission:

18. The primary role of the Commission will be to ensure that each competitive bidding process is fair in its design and implementation and to ensure that projects selected through each utility's competitive bidding processes are consistent with the utility's IRP Action Plan.¹⁸

¹⁴ See Consumer Advocate's Initial Statement of Position at 59-60; Consumer Advocate's Final Statement of Position at 29.

¹⁵ See Consumer Advocate's Final Statement of Position at 30.

¹⁶ Id.

¹⁷ See Consumer Advocate's Initial Statement of Position at 58-60; Consumer Advocate's Final Statement of Position at 30.

¹⁸ See Consumer Advocate's Initial Statement of Position at 45-50, 55-56; Consumer Advocate's Final Statement of Position at 4-5.

19. The Commission shall review each proposed RFP.¹⁹
20. The Commission will resolve disputes that arise among parties during the course of a utility's competitive bidding process.²⁰
21. The Commission will review of each signed contract resulting from competitive bidding processes.²¹

Ratemaking:

22. The costs that a utility reasonably and prudently incurs in designing and administering its competitive bidding processes should be recoverable through rates.²²
23. The costs that a utility incurs in taking reasonable and prudent steps to anticipate the need for backstop projects through "parallel" planning processes should be recoverable through rates.²³
24. The Commission shall consider each utility's performance in implementing competitive bidding in determining the utility's allowed rate of return in future rate proceedings.²⁴
25. The Commission may modify these guidelines if such action is found to be consistent with the public interest.²⁵

¹⁹ See Response to CA-PUC-IR-38; Consumer Advocate's Final Statement of Position at 5.

²⁰ See Consumer Advocate's Initial Statement of Position at 49; Response to CA-PUC-IR-45; Consumer Advocate's Final Statement of Position at 9.

²¹ See Consumer Advocate's Initial Statement of Position at 49; Consumer Advocate's Final Statement of Position at 5.

²² See Consumer Advocate's Final Statement of Position at 38.

²³ Id.

²⁴ See Consumer Advocate's Initial Statement of Position at 56; Consumer Advocate's Id.

²⁵ See Consumer Advocate's Final Statement of Position at 14.

APPENDIX F2

A PERSPECTIVE ON BEST PRACTICES

As is discussed in Section III of the Consumer Advocate's Final Statement of Position, best practices can encompass a broad set of strategies, plans, tactics, processes, methodologies, activities, and approaches for addressing competitive bidding. The processes by which competitive bidding occurs for supply- and demand-side resources are not simple ones. Benefits reside in the fact that best practices will emerge across a broad range of functions and activities. The Consumer Advocate anticipates that each utility, with a reasonable effort (via its own research or assistance from expert consultants), will be able to identify relevant best practices in designing effective RFPs.

In this Appendix, the Consumer Advocate offers a brief illustration of the various aspects of RFP design processes that would be addressed by best practices. As such, the following are examples of the circumstances in which a utility should look to best practices for guidance:

Setting A Foundation:

1. Best practices would dictate that a utility proposing to issue an RFP for incremental capacity and energy resources should take steps within an established regulatory framework to formally establish the need for incremental resources;
2. Best practices would offer guidance pertaining to how an affiliate might participate in a utility's RFP;

RFP Design:

3. Best practices would dictate the specific steps that a utility should take to ensure that its bidding process reasonably achieves

transparency objectives, while preserving an appropriate measure of bidder confidentiality.

4. Best practices would dictate whether a DSM RFP should be issued separately from any supply-side solicitation, and likewise whether renewables or DG requirements should best be addressed through separate solicitations;
5. Best practices would dictate the timelines according to which a competitive bidding process would unfold, including (potentially) the length of the period that respondents would have to submit bids in response to an RFP and the period across which prices received in response to a particular solicitation would be required to stay open;
6. Best practices would dictate that credit / performance assurance requirements that are appropriate to the resource being solicited be implemented;

Purchase Agreement:

7. Best practices may dictate whether a proposed purchase contract should be circulated with a utility's RFP;
8. Best practices may dictate whether a proposed purchase contract should be circulated to potential bidders before the RFP is formally issued, to create an opportunity to resolve in advance problematic provisions;
9. Best practices may dictate that "regulatory out" clauses be excluded from standard purchase agreement provisions;
10. Best practices may dictate that a proposed purchase contract should incorporate a milestone schedule for project development, with milestone requirements that are reasonable but appropriate to the utility's needs;

RFP Documentation:

11. Best practices will require that a utility should issue with its solicitation documents a very clear statement of the objectives that it seeks to achieve through the RFP'

RFP Implementation:

12. Best practices would dictate that, as a general matter, that an RFP should be distributed broadly (e.g., via advertisements in trade journals or other media known to be often reviewed by anticipated bidders);
13. Best practices may dictate that a contact person and central clearinghouse for RFP-related information should be established for a given solicitations;
14. Best practices may dictate when it is appropriate or necessary to bring an independent entity (e.g., an independent bid evaluator) into the RFP implementation process;

Final Steps:

15. Best practices would dictate that a utility work diligently to obtain Commission approval of any purchase agreement entered into as a consequence of an RFP process.

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing **DIVISION OF CONSUMER ADVOCACY'S FINAL STATEMENT OF POSITION AND APPENDICES APPENDICES F1 AND F2** was duly served upon the following parties, by personal service, hand delivery, and/or U.S. mail, postage prepaid, and properly addressed pursuant to HAR § 6-61-21(d).

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