

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF HAWAII

In the Matter of the Application of)
)
PUBLIC UTILITIES COMMISSION)
)
Instituting a Proceeding to Investigate)
Competitive Bidding for New Generating)
Capacity in Hawaii.)

DOCKET NO. 03-0372

DIVISION OF CONSUMER ADVOCACY'S

STATEMENT OF POSITION
APPENDICES 1 THROUGH 3

AND

CERTIFICATE OF SERVICE

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DIVISION OF CONSUMER ADVOCACY'S
STATEMENT OF POSITION

Pursuant to the purpose of this investigation set forth in Order No. 20583 and the procedural schedule set forth in Prehearing Order No. 20923, the Division of Consumer Advocacy (“Consumer Advocate”) files its Statement of Position on the issues identified by the Commission in Prehearing Order No. 20923 regarding competitive bidding as a mechanism for acquiring or building new generating capacity in Hawaii.

The Consumer Advocate hereby states its position that (1) competitive bidding can be expected to yield benefits for Hawaii; and (2) the Commission should take immediate steps to set a solid foundation for the implementation of competitive bidding by Hawaii’s electric utilities.

I. INTRODUCTION.

A. 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 are collectively referred to as the “HEI Companies”) and Kauai Island Utility Cooperative (“KIUC”) (collectively with the HEI Companies referred to as the “Electric Utility Companies”), and the Division of Consumer Advocacy (“Consumer Advocate”) were made parties to the docket.

On November 6, 2003, the Department of Business and Economic Development and Tourism (“DBED&T”) and the County of Kauai (“COK”) filed separate motions to participate without intervention. On that same day, Hawaii Renewable Energy Alliance (“HREA”) filed a motion to intervene. Johnson Controls, Inc. and Pacific Machinery, Inc. filed Motions to Intervene on November 7, 2003. The County of Maui and Hess Microgen, LLC, and The Gas Company filed their Motions to Intervene on November 10, 2003.

By Order No. 20834 filed on March 3, 2004, the Commission either granted the Motions to Intervene, or allowed the party to participate as a Participant, if the party’s Motion to Intervene was denied.

On June 30, 2004, Pacific Machinery, Inc. filed a Notice of Withdrawal informing the Commission. September 9, 2004, DBED&T filed a Notice of Withdrawal. By Order No. 21357, the Commission approved both notices.

B. SUMMARY.

As is developed more fully in this Statement of Position, the Consumer Advocate believes that establishing competitive bidding as the primary mechanism for energy

resource acquisition by Hawaii's electric utilities can be expected to produce the following benefits (Issue 1). 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 environmental, fuel diversity and other public policy goals by removing barriers to developers with innovative resource proposals.

Accordingly, the Consumer Advocate recommends that a competitive bidding system be developed as the primary mechanism to be used by Hawaii's electric utilities for acquiring or building new generation in Hawaii (Issue 2).

The manner in which a fair bidding system can be developed to achieve the benefits (Issues 2a through 3) will be addressed below. The actions that the Consumer Advocate recommends the Commission undertake are summarized as follows:

- The Commission should establish 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 Integrated Resource Planning ("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 Rules to enhance the benefits of competitive bidding by 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-a-vis its own competitive bidding process; and
- The Commission should identify the Commission review processes that would apply to a successful bidder.

The Consumer Advocate’s Statement of Position is organized by section, as follows:

- Section I provides background, including a discussion of the emergence of competitive bidding in the electric power industry and the Consumer Advocate’s definition of competitive bidding;
- Section II presents the Consumer Advocate’s assessment and conclusion that Hawaii can achieve benefits through competitive bidding; and
- Section III presents the Consumer Advocate’s recommendations regarding how to implement competitive bidding, by describing the important actions that need to be completed by the Commission.

C. BACKGROUND.

In Order No. 20583, the Commission noted that competitive bidding processes have been widely implemented throughout the United States and may serve as an alternative for Hawaii to facilitate wholesale market competition and enhance the

potential for higher efficiency and lower costs for its electric industry. The Consumer Advocate agrees that competitive bidding has been widely implemented and is of the view that it is a well-established practice for a wide variety of generation and energy resource acquisition situations. There is an extensive history to demonstrate that competitive bidding has been and continues to be widely used in the industry.

The Consumer Advocate also believes that competitive bidding can provide to Hawaii the benefits of wholesale market competition. The history of competitive bidding in the United States (“U.S.”) demonstrates that competitive bidding evolved to assure just and reasonable rates for the purchase of power and other resources, such as demand-side management (“DSM”) program measures. In the discussion that follows, the Consumer Advocate offers background information regarding the competitive bidding experience and its role in wholesale market competition throughout the U.S. and in Hawaii.

1. Public Utilities Regulatory Policies Act of 1978’s (“PURPA”) Role in Wholesale Competition.

Competitive bidding for generating resources has its roots in PURPA, adopted by Congress in 1978. Prior to 1978, power generation development was almost exclusively carried out by vertically-integrated electric utilities. The 1960’s and early 1970’s was a period of rapid growth in the industry and the new power generation development trend was increasingly one of nuclear power and larger scale facilities. In general, demand was growing rapidly and predictably and utilities were successfully meeting that demand with increasingly economical supplies of generation. In other

words, it was a growing, declining cost industry (i.e., there were evident economies of scale and the cost to produce a kilowatthour (“kwh”) was decreasing).¹

The cost structure of the industry began to change in 1973. Over the next few years, the combined effect of high oil prices, increasing environmental requirements, and nuclear power project cost overruns ended the declining cost nature of the industry and resulted in significant rate increases. There was also increasing concern that the utility industry’s focus on the development of large scale, central station generation was overlooking and preventing the development of smaller scale, renewable power production alternatives that offered cost sustainability and environmental advantages.

In response to these problems, Congress enacted PURPA in order to reduce dependency on oil, to increase reliance on renewable resources and energy efficiency, and to introduce marginal cost pricing.² A key element of this law was a requirement that utilities buy power from cogeneration and small power producers of renewable energy at a price not to exceed the utility’s “avoided cost.”³ This requirement created the first real opportunity for independent power producers (“IPPs”) (i.e., entities other than regulated utilities) to enter utility power markets.

¹ With the exception of the cost of fuel, the costs to produce a kilowatthour of electricity are primarily fixed, as opposed to variable.

² Marginal cost is the cost to produce the next increment/unit of energy over time, as opposed to embedded cost, which is the actual recorded cost.

³ “Avoided Cost” is a term that refers to the cost the utility would incur if it developed the power itself rather than buying from a small power producer.

2. 1978 to 1983: The Early Experience with PURPA.

The response to PURPA varied significantly from state to state. California, Maine, and a few other states acted quickly to establish regulations to allow independent power contracting to begin. By 1980, contracting had begun in these few states.

Utilities were generally reluctant to begin contracting for independent power. Many viewed independent power as a threat to their business and their ability to earn satisfactory returns on investments. With no established track record, there were many doubts about the ability of non-utility entities to operate their facilities according to the utilities' system reliability standards. There were also concerns that non-utility developers would build inexpensive, poor quality facilities that would not last through the contract terms and thus jeopardize the utilities' system reliability. Because of reliability concerns, utilities' preferences were to offer short-term, energy-only contracts, rather than long-term energy and capacity contracts.⁴

Several state regulatory commissions established rules and procedures to determine long-term avoided costs. These administratively-determined prices became the prices at which utilities were obligated to buy from all qualifying producers who offered to sell.⁵ Because fuel (primarily, oil) prices were high at the time, the initial "avoided cost" prices were high and triggered a vigorous response from all types of

⁴ Energy refers only to the kilowatthour electrical output provided by the non-utility developer. Capacity, on the other hand, refers to the utilities' ability to have some assurance that the power produced by the non-utility developer will be available when needed by the utility.

⁵ This approach is a "standard offer" approach that simply requires the bidder, on a "first-come, first-reward" basis, to meet the established qualifications and offer to sell at the established price benchmark. See the discussion in Section I.D.3 below.

producers. In California, this was termed a “gold rush.” By 1983, utilities in California and Maine were flooded with eager sellers, and utilities in each state had signed a number of long-term contracts.

Competitive bidding was not contemplated in the early implementation of PURPA because:

- there were very few independent producers, and none with any track record in the industry;
- the utility dominance of the generation market was seen as a significant market barrier to the small and newly-formed independent power producers; thus, the initial focus was on encouraging new entrants, breaking market barriers, and increasing options, rather than on purely minimizing cost; and
- independent producers were not viewed as competing with one another, but rather competing as a group against the utilities’ own generation.

3. 1984 to 1987: Initial Competitive Bidding.

Competitive bidding was first used to acquire generation capacity in 1984, and a number of utilities began the use of bidding systems in the ensuing years. It was a response to the flood of independent power proposals received under the early standard offer avoided cost offerings.

These first competitive bidding systems were used as a technical screening and ranking process. Utilities would identify a specific amount of power supply needed,

develop a forecast of “avoided costs” from their IRP⁶ process, and solicit bids to meet those requirements. A number of different systems were developed as each state and utility devised bidding systems that were consistent with their specific needs and regulatory requirements. These bidding systems addressed some of the operational problems initially encountered in the early contracts, but many continued to rely on administratively determined “avoided cost” benchmarks.

4. 1988 to 1992: Full Competitive Bidding.

By 1988, many utilities had developed experience with the integration of independent power options into their long range planning processes. The independent power industry had been established as a credible source of competitively priced power and as a permanent player in the generation market. The experience and sophistication gained by both the utilities and the independent power producers led to the advent of the first fully competitive solicitations.

By 1992, competitive bidding systems were widely used. The use of administratively-determined avoided cost benchmark prices gave way to price competition amongst suppliers by way of competitive bidding, particularly for those

⁶ Traditionally, utilities focused on building new facilities to meet the increasing demand for energy. IRP was instituted to integrate actions that would reduce the demand for energy as a means of meeting the electric utilities’ customers’ energy need. Thus, IRP was a process that considered both demand side management (“DSM”) and supply side options to meet the forecasted load of a utility’s customer. Furthermore, since it takes time to plan for the construction of facilities needed to serve the load, utilities traditionally looked at the long-term forecast in order to ensure that the facilities would be available when needed. IRP opened the planning process to the public and allowed for public input into the decisions that are made. In addition, IRP rules implemented in at least some states attempted to coordinate purchases (*i.e.*, under PURPA and otherwise) with utility needs. This served to remedy occasional problems where state PURPA rules had led to purchases of energy and capacity that was not needed, thus resulting in excess capacity and unnecessary costs to consumers.

utilities that had come to rely significantly on the independent power market for its power supplies. Enhancements were made in the process. Contracting with respect to pricing, operating flexibility, and technical qualifications became standardized, and thus more efficient. Bidding itself was evolving such that, by this time, the utilities' bidding practices were becoming more like competitive procurements typical of other markets and less like the tightly regulated processes of the mid-1980s.

An August 1990 report by the United States General Accounting Office⁷ indicated that 41 competitive bid solicitations had been issued in 19 states by the end of 1989. A series of reports prepared by the National Independent Energy Producers ("NIEP")⁸ document the continued evolution of competitive bidding processes through the emergence of electric industry restructuring in the mid-1990s. NIEP's July 1993 report (at 5) states that:

[B]idding for new power supply is widely used in the electric utility industry. As of February 1993, 70 utilities have issued 107 requests for proposals for 26,237 megawatts. In response, they have received bids for 230,074 megawatts and selected 18,679 megawatts of winning bids.

As early as 1987, there was movement to broaden the scope of competitive solicitations to include not just PURPA Qualifying Facilities ("QFs"),⁹ but other

⁷ See GAO/RCED-90-182, at 3.

⁸ See, for example, NIEP publications that include: *Bidding For Power: The Emergence of Competitive Bidding in Electric Generation* (March 1990), *Competing For Power: A Survey on Competitive Procurement Systems and Blueprint for the Future* (July 1991), *Planning For Competition: Integrated Resource Planning and the Independent Power Industry* (July 1993).

⁹ A qualifying facility is a cogeneration facility or a small power production facility that meets the criteria contained in 18 CFR Part 292 (relating to regulations under sections 201 and 210 of PURPA with regard to small power producers and cogenerators). The FERC defines a cogeneration facility as a generating facility that produces electricity and another form of useful thermal energy (such as heat or steam) used for industrial, commercial, heating, or cooling purposes. To receive status as a QF under PURPA, the facility must produce electric energy and "another form of useful thermal energy through the sequential use of energy," and meet certain

independent power producers as well as demand-side projects. For example, a September 1987 article in *Public Utilities Fortnightly* describes Federal Energy Regulatory Commission (“FERC”) Chairman Margaret Hesse’s recommendation to extend competitive bidding to IPPs and utility resources. Apparently this idea took hold quickly; by 1990, requests for proposals (“RFPs”) issued by utilities in nearly 20 states had expanded their competitive solicitations to include proposals from both QFs and non-QF IPPs. Some states had in fact moved fully to all-source bidding, which allows participation by the full range of supply and demand-side options.¹⁰

5. 1992 to 1996: Transition to Full Deregulation of Generation Markets.

By 1992, the cost structure of the U.S. power market was positioned for another major turn. Through the 1980s, energy prices continued to increase for many utilities as the high costs of nuclear units and early independent power contracts became operational and entered into rates. In contrast, the independent power industry had matured, oil and gas prices had declined substantially, and new, more efficient power production technology became available.

These developments and the trend in some other countries to deregulate electric generation led to Congress’ passage of the Energy Policy Act of 1992 (“EPACT”). This law expanded the types of generation that could be developed through independent

ownership, operating, and efficiency criteria established by the FERC. The FERC defines a small power production facility is a QF whose (1) capacity does not exceed 80 megawatts, and (2) primary energy source is biomass, waste, renewable resources (including hydro), or geothermal resources. In short, these are facilities under a given size that are constructed by non-utility entities to produce power using non-fossil fuel.

¹⁰ See NIEP’s *Bidding For Power: The Emergence of Competitive Bidding in Electric Generation* (March 1990) at 17.

power projects and instituted requirements for open access to transmission systems for independent producers.

During this period, the level of activity in competitive bidding declined due to the slow growth in demand and surplus capacity in many regions of the United States. However, competitive bidding became widely recognized as an important mechanism for securing power from suppliers in competitive wholesale power markets. One competitive bidding enhancement in this time period was the inclusion of option concepts, such as the provision for flexibility in the project development schedule (which can offer value in the event need forecasts change).

Also in this period, PURPA's implementation policy shifted. The independent power market had grown and matured. At this point, the independent power industry had become an integral part of the wholesale power market and the policy focus shifted from the creation of an independent power industry to the establishment of competitive markets which included independent power producers. The following excerpt from a 1995 FERC order¹¹ provides an example of this:

In contrast to 1978, non-traditional producers, including QF's, now provide well in excess of half of all new generating resources, and the Commission has determined that there is no longer any dominance in the provision of new generation capacity . . . Since 1980, the Commission has given wide latitude in implementing PURPA. We have done so partly in recognition of the important role which Congress intended to give the States under PURPA, as well as to avoid unnecessary interference with state efforts to maximize the development of QFs. However, as noted above, the QF industry is now a developed industry and the need for integration of policy objectives under PURPA and other federal electric regulatory policies is pronounced. This is particularly the case given the fact that the electric utility industry is in the midst of a transition to a competitive wholesale power market and some states, including California, are considering direct access for retail customers.

¹¹ *Southern California Edison Company and San Diego Gas & Electric Company*, 70 FERC 61,215 (February 23, 1995).

As the electric industry becomes increasingly competitive, the need to insure that States are using procedures **which insure that QF rates do not exceed avoided costs becomes more critical**. This is because **QF rates that exceed avoided costs will, by definition, give QFs an unfair advantage over other market participants (non-QFs). This, in turn, will hinder the development of competitive markets and hurt ratepayers, a result clearly at odds with ensuring just and reasonable rates required by PURPA**, section 210(b). [Emphasis added.]

It is also clear from several FERC orders in this period that competitive bidding and administrative methods were both accepted and established methods for determining avoided costs, provided that the methods included all options available to the utility, as noted by FERC elsewhere in the same 1995 order cited above:

[U]nder PURPA an avoided cost (incremental cost) determination must permit QFs to participate in a non-discriminatory fashion and, at the same time, **assure that the purchasing utility pays no more than the cost it otherwise would incur to generate the capacity (or energy) itself "or purchase from another source."** Congress in this language did not in any way limit the sources to be considered. The consequence is that regardless of whether the State regulatory authority determines avoided cost administratively, through competitive solicitation (bidding), or some combination thereof, it must in its process reflect prices available from all sources able to sell to the utility whose avoided cost is being determined. **If the state is determining avoided cost by relying on a combination of benchmark and bidding procedures, as here, this means that the bidding cannot be limited to certain sellers (QFs); rather, it must be all-source bidding.** [Emphasis added.]

In effect, by 1995, PURPA policy had shifted such that all options, both utility and independent power, were competing with one another. Utility planning, if based on administrative methods excluding the use competitive bidding, was to nevertheless consider all options head-to-head so as to try to accomplish a result similar to that which would result from all-source competition.¹²

¹² The Consumer Advocate notes that this approach is consistent with its recommendation to the Commission in Statements of Position submitted in Docket Nos. 04-0346 and 04-0365.

6. Recent Competitive Bidding Experience.

Electric industry restructuring activities during the 1996 to 2000 period supplanted much of the PURPA-related competitive bidding activity. Direct market competition and the development of an independent power industry and competitive market for all generation (not just PURPA QFs) became the primary focus throughout much of the U.S.¹³ However, following the market crisis in California in 2001 and the subsequent financial difficulties within the independent power producer sector, resource planning and competitive bidding have reemerged in many areas. The following are a few examples of this trend:

- A June 2003 Public Utilities Fortnightly article entitled *Back to Bidding*, asserts that in the wake of the national foray into retail access, integrated resource planning and competitive bidding processes are being welcomed by regulators as a “tried and true” approach. That article points to Idaho Power and PacifiCorp as utilities that have reengaged competitive procurement processes.
- A recent Calpine, National Resources Defense Council, and PacifiCorp joint publication¹⁴ reports that an increasing number of states are requiring load serving entities to undertake competitive bidding processes to procure incremental and replacement power supplies. It points to, among other things, a recent Montana statute requiring the use of “open, fair and competitive procurement processes whenever possible” and Oregon guidelines for competitive bidding as a mechanism to achieve “the least cost planning goal of acquiring the resource mix with the best combination of costs and variance of costs.”
- The California Public Utilities Commission (“CPUC”) recently conducted a rulemaking proceeding examining the procurement of

¹³ It should be noted that in its Statement of Position filed in Docket No. 96-0493, the Consumer Advocate concluded that it was not feasible to restructure the electric industry in Hawaii to allow wholesale competition of supply through a single, central energy market administered by an independent system operator.

¹⁴ *A Joint Proposal to State Utility Regulators: Defining Electricity-Resource Portfolio Management Responsibilities* (July 2003).

long term resources by electric utilities and renewed its commitment to competitive bidding processes.¹⁵

In addition to a reemergence of competitive bidding in the context of IRP, competitive bidding is used by Regional Transmission Organizations to address system reliability concerns in retail access environments:

ISO New England, the operator of New England's bulk power grid, recently issued a "GAP RFP", addressing a need for more generating capacity and/or demand response in a specific transmission-constrained location in Connecticut.

Today, the competitive solicitation of resources is widely used in areas with retail competition and those that have retained traditional retail regulation.

7. Hawaii's Experience with Competitive Bidding.

The Consumer Advocate notes that competitive bidding has a history in Hawaii, as well. For example, HECO has experience with competitive bidding for power supplies. In June 1987, HECO issued a request for proposals for purchased power alternatives (see 105 PUR 4th at 63-64). In August, HECO received seven serious bids, with 13 total possible options. HECO's contract for a 180 MW supply from Kalaeloa Partners, L.P. and its contract to purchase from the AES Barbers Point facility both resulted from that competitive bidding process. The Consumer Advocate notes that Amendments 5 and 6 to the Kalaeloa Partners contract -- that would increase HECO's purchase rights to 209 MW -- are currently before the Commission. The Company has indicated that approval of these amendments would bring benefits to the

¹⁵ See CPUC Decision 04-01-050.

Company and its customers in the form of savings relative to avoided costs.¹⁶ Both projects added reliable resources to the Company's supply base at prices below the costs of the Kahe 7 facility that HECO otherwise had been considering.

The Consumer Advocate observes that HECO's affiliates also are familiar with competitive processes. HEI Inc. recently reported in its 10-Q report to the Securities and Exchange Commission for the quarter ended September 30, 2004, that its Renewable Hawaii, Inc. ("RHI") subsidiary solicited competitive proposals from developers of renewable power projects. RHI has initial corporate approval to invest up to \$10 million in renewable energy projects. Beginning in 2003, RHI solicited competitive proposals for investment opportunities in projects (1 MW or larger) to supply renewable energy on the islands of Oahu, Maui, Molokai, Lanai and Hawaii. RHI is seeking to take a passive, minority interest in such projects to help stimulate the addition of cost-effective, commercially viable renewable energy generation in the state of Hawaii. HEI's 10-Q states that investments by RHI will be made "only after the developers secure the necessary approvals and permits and an approved PPA with HECO, HELCO or MECO."

Moreover, in 1996, the KIUC (formerly known as Kauai Electric, a Division of Citizens Communications Company) conducted a successful competitive bidding process that led to a contract with Kauai Power Partners for the output of 26.4 megawatt (nominal) combustion turbine electric generation facility located in the

¹⁶ In this case, avoided costs are calculated relative to a "proxy" unit representing "the next generating unit planned for in HECO's 2nd integrated resource plan." See HECO's Application (at 16) filed with the Commission in Docket No. 04-0320.

Lihue Energy Service Center on Kauai, Hawaii. That facility has since been acquired by KIUC, which also has acquired the Kauai Electric Division.

D. IMPORTANT LESSONS FROM THE U.S. EXPERIENCE WITH COMPETITIVE BIDDING.

The foregoing review of the implementation of competitive bidding in response to PURPA reveals several important lessons that merit some discussion. These lessons are presented below.

1. Lesson 1: The Observed Benefits Of Competitive Bidding.

The proposition that competitive bidding offers benefits is demonstrated by and is inherent in the extensive body of experience in the U.S. over the past two decades. Competitive bidding has helped to assure just and reasonable prices to consumers and 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 environmental, fuel diversity and other public policy goals by removing barriers to developers with innovative resource proposals.

2. Lesson 2: Competitive Markets Offer A Range Of Resource Options.

The overarching principle associated with competitive bidding is the assurance that all available resource options are considered in utility planning. This principle was a primary reason for the creation of PURPA in 1978, that is, to encourage utilities to consider alternatives that had not been previously considered. This same principle is evident in the 1995 FERC order cited above, which stressed the consideration of all sources in determining avoided costs and assuring just and reasonable rates. It is clearly evident in FERC's actions to fully deregulate prices in the power generation sector, which allowed any form of generation (not only PURPA QFs) to be owned and operated by non-utility, independent generation companies.

Over the past two decades, PURPA and subsequent measures to open power markets to non-utility competitive suppliers have created a substantial marketplace with a large number and type of such suppliers. As is noted in the Section I.C. Background discussion above, this marketplace, which was non-existent in 1978, was mature and developed by 1995 and has developed even further under the market competition initiatives of the past decade.

In addition, important advances have been made in generation technologies, particularly smaller generation technologies (such as combined heat and power and other distributed generation equipment, wind generators, fuel cells, solar cells, etc.), along with a range of demonstrated demand-side program options. Competitive non-utility businesses and industries have grown up around the provision of the equipment, as well as project development and operation, by which we mean to include DSM.

Today, there are many firms that specialize in non-utility supply- and demand-side technologies. In other words, there are others whose expertise in the design, development, and operation of these facilities may exceed the capabilities of any utility and will generally exceed the expertise of relatively small ones. Thus, a utility seeking to maximize performance of the generation and minimize costs cannot ignore these options.

The fact that many of these technologies are available in smaller increments (i.e., relative to the size of larger, central-station generating plants) means that more sophisticated resource plans can be developed that employ a larger number of smaller, sometimes localized, supply- and demand-side resources. Such sophisticated solutions are particularly attractive in Hawaii's complex resource planning environment.

3. Lesson 3: There Are Multiple Methods For Tapping Competitive Markets for Generation and Other Energy Resource Options.

At issue in this proceeding is the manner in which competitive markets offering generation facilities and other energy resource options will be tapped in order to deliver maximum benefits to Hawaii.¹⁷ Primarily through IRP proceedings, an electric utility's needs for capacity and energy will be defined in advance. This market, however, has evolved in complexity, in the level of competition among providers, and in the range of product and service offerings. Multiple approaches can be used to acquire power from this market, including methods by which third-party providers would design, own and

¹⁷ The market referenced here is defined by the collection of independent developers of generation projects and energy service companies that offer wholesale power resources (megawatts or "negawatts") under contract from specific facilities. In grid-based systems on the mainland, wholesale markets encompass these options, as well a broader set of power supply options that include contracts for wholesale power that are not specific to individual facilities.

operate resources that contractually provide capacity and energy to electric utilities. At present, there are a number of well-established mechanisms for procuring goods and services from third-party providers. Competitive bidding is one. The others include auctions, standard offers, and selection through direct negotiations, as well as approaches that combine elements of these mechanisms (e.g., competitive bidding using direct negotiations with a finalist group). The four methods of tapping competitive markets are described more fully below.

Competitive Bidding is well-suited to situations in which multiple objectives are to be considered and weighed in selecting a good or service. This is typically the case (1) where factors other than price are important; (2) where the commodity is not uniform; (3) where there is flexibility in the amount to be procured; and/or (4) where negotiation with the highest-ranking bidder or bidders is contemplated. Importantly, competitive bidding also is adaptable to situations where substantial variation in the products offered is anticipated – or desired. Competitive bidding may be the most effective approach where, for example, different terms and conditions are in order, location-based effects are relevant, operating characteristics for technologies are quite different, project and technology risks are unique, and developer experience is important. In the energy industry, competitive bidding has been widely used by utilities that have sought power supplies from a mix of resources, or from resources with different technologies, fuels or pricing structures. Competitive bidding has been used extensively to secure needed supply- and demand-side resources from third-party suppliers.

Standard Offers provide eligible suppliers of goods and services with the opportunity to avail themselves of predetermined “price” and “non price” terms in completing a transaction. In essence, standard offers are a simple auction format, with a clearing price that is administratively set in advance. The advantage of standard offer procurement mechanisms is that they are relatively simple and inexpensive to administer. They also present less risk to project proponents, which can increase market response to a given need. Standard offers are challenging because establishing a standard set of terms and conditions suitable for most potential project proponents can be difficult. Also, identifying appropriate threshold pricing levels can be problematic. Standard offers have been used in the power industry. For example, many states established purchase obligations for utilities that received sales offers from qualifying facilities under PURPA; here the threshold price typically was a short term

avoided cost rate. Because the quantities purchased from any given supplier through a Standard Offer typically were small, the potential risks to the utility's system also were limited. These circumstances enabled the development of "standard contracts" by which the terms of purchase by the utility were fixed in advance.¹⁸

Direct Negotiation is a third method by which goods and services can be procured from competitive markets. An entity seeking to purchase may directly approach known providers (or may be approached by providers) and the "price" and "non-price" terms of a transaction would be negotiated. Direct negotiation can be an acceptable means of tapping competitive markets under many circumstances, particularly where it is clear that only one (or perhaps two) providers have the ability to meet the purchaser's requirements. However, direct negotiation can give rise to concerns in regulatory environments because ratemaking schemes often anticipate dollar for-dollar recovery of costs incurred. Competition is preferable so as to insure against (or minimize the possibility of) inflated prices or inferior performance.

Auctions work well in circumstances in which the good or service is sufficiently defined such that the winner can be determined solely by its price and not by other factors, such as location or differential environmental impacts. In short, auctions are effective in commodity markets. In certain power markets, for example, energy is transacted on the basis of hourly auctions. Alternately, New Jersey meets customer needs for its Basic Generation Service through periodic auctions conducted on a statewide basis. In both instances (1) the auction procurement targets are fixed; (2) power delivery is not in question once the bidders qualify (*i.e.*, bidders must demonstrate that they are licensed and creditworthy); (3) the contracts are standard (such that "price" is the only point of comparison); and (4) the winning bids are unambiguous. Auctions can be structured such that the winning bidders can be paid the same price, known as a "market clearing price" or "uniform price," or they can be paid their bid price. The choice may depend upon the specific details of the auction and the type of auction utilized; conversely, the choice also may influence the selection of a specific auction model. Ascending-bid auctions, descending-bid auctions, and multiple unit auctions are three such models.

¹⁸

Note that the complexities of interconnection for larger generating facilities render the development of fully "standard" contracts infeasible. Nonetheless, such contracts have been developed that seek to specify some contract terms and/or establish a starting point for subsequent contract negotiations.

Thus, competitive bidding is but one method for tapping competitive markets for capacity and energy resources from third-party suppliers. The Consumer Advocate's recommendations in Section II focus on competitive bidding as distinct from the other three methods. However, there may well be situations in Hawaii where other methods, particularly standard offers or direct negotiations may be useful alternatives.¹⁹

4. Lesson 4: Competitive Bidding Can be Successfully Employed in a Range of Complex Resource Procurement Situations.

Competitive bidding is well-established in the power industry, and is particularly well-suited to the complex environment of developing the IRP for a utility. Competitive bidding processes typically incorporate the following elements:

- An RFP is issued to the competitive market notifying potential bidders of the utility's intent to purchase; the RFP documents typically include a draft contract;
- The RFP identifies the factors that will be used in evaluating bids, which would almost certainly include price and, depending on the resource being procured, various non-price attributes;
- Interested third-party suppliers (of supply- and/or demand-side resources) would submit formal bids to the utility;²⁰

¹⁹ It should be noted that auctions may not be applicable to Hawaii's energy market. The Consumer Advocate anticipates that electric utilities in Hawaii will rarely be in a position where they are seeking to purchase electricity on a commodity basis. The environmental, fuel diversity and other such impacts of the facilities at which such a commodity might be produced are simply too important to Hawaii. Standard offer purchases may be desirable from time to time. The Consumer Advocate can envision circumstances under which an electric utility may, for example, wish to establish a standard offer for very small quantities of supply from CHP facilities.

²⁰ Implicit throughout the Consumer Advocate's Statement of Position is the expectation that competitive bidding refers to processes that would result in electric utilities obtaining contractual rights to capacity and energy resources from facilities (or DSM measure installations) that a third-party would own and operate. This view of competitive bidding would not, for example, encompass RFPs for power plant components that would be procured to construct the facilities whose cost would be reflected in ratebase; or RFPs for facilities that would be developed by third-parties but turned over to the utility on a "turnkey" basis.

- The utility would evaluate those bids based on predetermined criteria;
- A contract would be signed, sometimes (but not always) after negotiations to improve the terms of the deal proposed by the bidder and/or the utility, in which the “price” and “non-price” terms of the deal are specified; and
- Some measure of review by a state public utility commission or the Federal Energy Regulatory Commission is typical.

The Consumer Advocate notes that, because competitive bidding anticipates comparison of competing resource options using price and non-price criteria, it is conducive to the evaluation of different sets of resource options in a way that the other procurement methods are not. Therefore, the Consumer Advocate concludes that competitive bidding, in the IRP context, offers a particularly effective strategy to utilities attempting to solve complex problems in resource planning and procurement.

5. Lesson 5: Competitive Bidding Is Widely Used By Both Large And Small Electric Utilities To Procure Needed Resources.

As noted above, competitive bidding is a well-accepted approach to resource acquisition in the electric utility industry. Importantly, competitive bidding is used by large and small utilities to procure needed resources. On one hand, the California Public Utilities Commission recently issued an order reestablishing competitive procurement as the preferred method by which its electric utilities – which are among the Country’s largest – should secure long-term capacity resources. On the other hand, many small utilities in Maine, New Hampshire and Vermont have relied on and continue to rely on competitive procurements to meet their resource needs. Some of these

smaller utilities have been successful in issuing all-resource solicitations that were open to proposals from both supply- and demand-side bidders.

Competitive bidding does not require substantial incremental cost relative to the planning and resource development activities that utilities must perform, especially after a base of experience is established by a utility (as discussed further below). The broad experience with competitive bidding, particularly its wide use by smaller utilities, is indicative of the fact that the cost to conduct a solicitation is not a material barrier to its use. Sound application of competitive bidding can also facilitate cost recovery proceedings.

6. Lesson 6: Competitive Bidding Can Be Used Directly as a Measure of a Utility's Avoided Costs.

As in other states, the Legislature enacted statutes²¹ and the Commission adopted rules²² for implementing PURPA. Some have argued that the established statutes and rules currently create an obligation for Hawaii's utilities to sign long-term contracts with QFs at a utility's short-term avoided cost rates, which typically are based on the dispatch costs of its existing generating fleet.

By contrast, as discussed above, other states have evolved in their implementation of PURPA's requirements to a point where the acquisition of resources under long-term contracts occurs through competitive bidding. The Consumer Advocate observes that such approach represents a substantial benefit to ratepayers because the contract costs that ratepayers must support are no longer tied to avoided

²¹ See HRS § 269-27.2.

²² See HAR § 6-74.

costs (which can be quite high under some circumstances), but rather to bid prices in RFPs where competitive pressures hold bid prices to minimum levels (e.g., as may be needed to sustain the most efficient provider). Remedying this problem by requiring competitive bidding where new resource acquisitions are at issue has the potential to benefit Hawaii by saving consumers many millions of dollars.

II. COMPETITIVE BIDDING CAN BE EXPECTED TO YIELD BENEFITS.

This Section of the Consumer Advocate's Statement of Position explores whether competitive bidding, if implemented by the Commission, could be expected to yield benefits in Hawaii. The discussion proceeds in three parts. First, the Consumer Advocate recaps, in summary form, the various benefits that the national experience shows can be achieved through competitive bidding. Second, we explore Hawaii's foreseeable needs for incremental resources and offer an assessment of the likelihood that competitive bidding can be an effective mechanism for procuring such resources. Each represents an opportunity to use competitive bidding to bring benefits to Hawaii. Finally, we address several factors that have the potential to occasionally limit the benefits achievable through competitive bidding in Hawaii.

A. THE POTENTIAL BENEFITS OF COMPETITIVE BIDDING IN HAWAII.

Competitive bidding offers Hawaii the same benefits as have been achieved by large and small electric utilities in other jurisdictions. 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;²³
- 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 environmental, fuel diversity and other public policy goals by removing barriers to developers with innovative resource proposals.

In short, competitive bidding will allow electric utilities and industry stakeholders in Hawaii to answer the question: *In responding to an identified need, is there a better, more cost-effective resource (or set of resources) than the one that the utility has proposed?* As is discussed in the section that follows, Hawaii has near-term needs for which competitive bidding should be deployed to answer this question.

B. HAWAII'S ELECTRIC UTILITIES NOW HAVE NEEDS FOR VARIOUS SUPPLY- AND DEMAND-SIDE RESOURCES WHERE COMPETITIVE BIDDING CAN YIELD BENEFITS.

Hawaii has near-term needs that present opportunities to reap the benefits of competitive bidding. In many instances, these needs take the form of anticipated requirements for incremental capacity and energy resources, which can be affected by

²³ The Consumer Advocate emphasizes that competitive bidding offers this important benefit to Hawaii. The Legislature has clearly established a goal to "free" consumers from the costs of fossil-fueled generation. Unfortunately, many purchases under Hawaii's PURPA rules are tied to avoided costs, which in turn are calculated as a function of the costs of oil-fired generation. Under this construct, Hawaii may reduce its reliance on oil-fired generation but it does not alter the proportion of its supply that is based on the cost of oil. As discussed above, precedent for PURPA implementation establishes that competitive bidding can effectively "redefine" avoided costs to be those of the best proposal in a competitive bidding process. Such a change would bring substantial benefits to Hawaii.

a range of factors, including load growth, mechanical and economic obsolescence of existing resources, and public policy initiatives. Competitive bidding will often be an effective mechanism for acquiring capacity and energy resources necessary to meet service obligations.

In this Section, the Consumer Advocate presents a set of specific resource needs that are likely to be encountered by Hawaii's electric utilities in coming years. Examples of competitive bidding processes that have been conducted to address the specific types of resource needs are also described. It is the Consumer Advocate's view that each need-type discussed below presents future opportunities for Hawaii to obtain the benefits described above.

1. Large Increments of New Capacity.

a. The Nature Of The Likely Future Need.

From time to time, some electric utilities can be expected to require large increments of new generation due to load growth and plant obsolescence. The Consumer Advocate considers "large" incremental capacity needs to be those that are on the order of 20 MWs or more, although this is not intended to be a precise measure. Such needs may be met through a "central" generation resource – whether peaking, intermediate or baseload – in which the optimal resource might be, for example, a 20 MW combustion turbine.

HECO indicates that it has current needs that fall into this category. In its recent rate application, for example, the Company states (see HECO T-1, at 11) that it currently is seeking to defer to 2009 the need for large, new central-station generating

unit (a combustion turbine for peaking purposes). The rate application also describes an immediate need for “40 MWs or more” of additional firm capacity (see HECO T-1, at 11), which it hopes to meet through a combination of upgrades to the Kalaeloa Partners, L.P. generating facility, expanded DSM programs, and CHP installations.

b. Competitive Bidding Can Offer An Effective Response.

As previously discussed in Section I.C.7. above, HECO and KIUC have experience using competitive bidding processes to procure large increments of new capacity and energy from generating facilities that are owned and operated by third parties. This experience demonstrates that Hawaii’s utilities can successfully implement a competitive bidding process to procure large increments of new generating capacity from third-party suppliers. The Consumer Advocate anticipates that lessons learned will both inform and facilitate future competitive procurements of this nature.

It should be noted, however, that there likely will be circumstances in which there will be more effective strategies for addressing needs for large increments of new capacity. Such strategies might include the acquisition of multiple smaller generating units; perhaps two 10 MW peaking units located in diverse sections of a utility’s system might better satisfy its 20 MW need. Furthermore, generation-only solutions are not the only viable strategies. Demand-side strategies also can be effective. There has been a growing recognition over the past several years of the value of demand-side resources, by which we mean both efficiency improvements and load management programs. Most demand-side programs are implemented by competitive, non-utility companies where the role of the utility is, typically, to organize the effort (administer the contracts

with the DSM providers), to assist the companies (provide relevant information and the like) and to provide the requisite funding. The Consumer Advocate expects that, in designing the DSM programs and selecting the DSM providers, Hawaii's utilities already engage in competitive processes. This would (or should) certainly be the case for HECO, which has stated a significant need for new DSM programs and whose market is sufficiently large to attract a significant number of DSM providers. Competitive bidding processes should be among the mechanisms a utility uses to select DSM providers to implement its DSM programs.

The Consumer Advocate notes that there is substantial evidence from outside Hawaii that competitive bidding processes open to bids from demand-side providers have been successfully implemented. For example, ISO New England recently issued (December 2003) an RFP to address local reliability deficiencies in Southwest Connecticut. The resources selected provided approximately 125 MW of additional capacity during the summer of 2004 and will provide up to 255 MW by the summer of 2007. The capacity is from demand reduction, which in this instance includes both emergency generation and reductions in electricity use, and from more traditional conservation resources. According to the ISO, the demand reduction resources procured through this competitive bidding process performed at a very high level (i.e., they were available when called upon) during summer 2004.

2. Distributed Generation For Local Reliability.

a. The Nature Of The Likely Future Need.

On occasion, Hawaii's electric utilities can be expected to require distributed generation ("DG") resources to provide limited increments of capacity or energy in specific locations. Distributed generation might be needed in a segment of a utility's system with growing demands that, absent local generation, would require a substantial transmission and distribution facilities upgrade. Under such circumstances, one or several relatively small generating facilities (e.g., 1 MW internal combustion engines) might be a more cost-effective solution. Hawaii's electric utilities have relied on distributed generation in such circumstances. For example, HELCO installed four 1 MW diesel engines to address a generation shortfall when the Puna Geothermal Ventures facility did not come on line as expected. Another utility need for local generation support is reflected in action by MECO to install a small generating unit at its Hana substation to address the need to get generation to Hana when a transmission line was taken out of service for maintenance. In a recent briefing on its March 2005 Adequacy of Supply report, HECO indicated that it is considering leasing 1.5 MW combustion turbines, which might be located at any of four substation sites, to address peaking capacity shortfalls in the near future.

b. Competitive Bidding Can Offer An Effective Response.

On occasion – because of high local load growth, for instance -- local, grid based generation can allow a utility to avoid more costly (or environmentally unacceptable) transmission and distribution infrastructure improvements. Obviously, the concept of

locating grid based generating supplies “close to the load” is not a new one in utility planning. In many ways, the generating facilities that Hawaii utilities have placed in or near load zones to avoid construction of new transmission lines are by their very nature “distributed generation for local reliability.” However, their provision by non-utility owners and operators is a more recent market development. The Consumer Advocate accepts that, in an era in which large transmission facilities have become increasingly prevalent, smaller facilities intended to respond to a utility’s needs would be the focus of DG installations. Thus, the question here is whether the third party provision of grid based generation can be accomplished through competitive bidding processes.

The Consumer Advocate believes that, in those instances in which third-party operation of grid-based generation can be accommodated by the utility (see the Long Island Power Authority (“LIPA”) example in the next paragraph), there is no *a priori* reason to assume competitive bidding for DG installation rights cannot be implemented. In fact, the GAP RFP issued by ISO New England (as discussed above) is a good example of a competitive bidding process whose objective was to address a local need for incremental capacity and energy. Again, the purpose of that solicitation was to address local reliability deficiencies in Southwest Connecticut.

More recently, LIPA issued an RFP seeking fuel cells to meet a specific local need on its system. LIPA’s February 2005 RFP seeks proposals for the construction and operation of a 10 MW fuel cell to be located at its West Babylon substation. Obviously, LIPA believes that its distribution operations will not be affected negatively by the independent operation of the fuel cell within the substation’s boundaries. Competitive bidding processes such as these are replicable in Hawaii.

3. Customer-Sited Distributed Generation.

a. The Nature Of The Likely Future Need.

A utility's local or system-wide forecasts might indicate that customer-sited generating capacity would be beneficial. As noted above, HECO's current rate application indicates its intent to address its need for additional capacity in part through customer-sited DG in the form of CHP installations (see HECO T-1, at 11).

b. Competitive Bidding Can Offer An Effective Response.

Because customer-sited CHP is an emerging technology, the Consumer Advocate cannot provide specific examples of competitive bidding for such supplies. Nonetheless, it is clear that programs can be designed by utilities needing additional capacity resources to introduce appropriate incentives for cost-effective CHP and other customer-based DG applications. In some circumstances, competitive bidding might be seen as an appropriate procurement mechanism for identifying preferred suppliers. This likely is true particularly when the likely DG facilities are relatively sizable and when there are a number of customer-based options that could mitigate or satisfy the utility's local requirements. Clearly, a customer's investment decision is between it and the DG supplier – who, presumably the customer would select from a market including independent, competitive suppliers. The utility's primary role would be to clearly identify its specific locational requirements and, where sensible, to provide incentives for cost-effective installations. The Consumer Advocate's specific views on DG applications are as described in its May 2004 Statement of Position, as filed in Docket No. 03-0371.

4. Resources For Compliance With Public Policy Initiatives.

a. The Nature Of The Likely Future Need.

Public policy initiatives in Hawaii will, from time to time, require electric utilities to procure incremental resources. In the past, a strong public policy interest in conservation and load management has caused electric utilities to procure demand-side resources. Act 95, by which the Legislature recently enhanced Hawaii's renewable portfolio standard ("RPS"), will similarly require the electric utilities to procure renewable resources. Under the new law, electric utilities are required to meet a renewable portfolio standard of 15 percent in 2015, and a goal of 20 percent in 2020. Recent applications to the Commission have seen both HELCO and MECO preparing to include new wind facilities to their systems, in part in response to Hawaii's RPS.

b. Competitive Bidding Can Offer An Effective Response.

Competitive bidding is an effective and efficient mechanism for responding to public policy initiatives in Hawaii, particularly where sizeable capacity resources are under consideration. The new RPS requirements implemented by Act 95 can be expected to continue to inspire such opportunities. The Consumer Advocate notes, as is discussed above, that the renewables market affiliate of HECO, HELCO and MECO recently solicited competitive offers from wind farm developers. The Consumer Advocate contends that competitive bidding is a mechanism by which such resources could be acquired in a manner that would (1) be fully consistent with state and federal PURPA rules and (2) likely bring renewable resources at considerable cost savings to consumers.

Other jurisdictions have successfully used competitive bidding to secure new generating capacity provided by third-party suppliers of renewable resources. An RFP issued in January 2005 by the New York State Energy Research and Development Authority (“NYSERDA”) provides an example of a competitive bidding process for procuring renewable attributes and, as a consequence, for facilitating the financing of renewables projects. NYSERDA issued its RFP seeking bids from developers willing to contract to supply the rights to environmental attributes created by RPS-eligible generation resources. NYSERDA’s RFP is part of a strategy to achieve New York’s RPS goal of increasing the amount of electricity sold to consumers in New York State that is generated from renewable resources to at least 25 percent by 2013. Twenty-two proposals were received from this solicitation, which was the first of many that will be issued over the next several years to fully implement the RPS program. This particular RFP process was done in an expedited manner and was seeking only those projects that would be in-service by year-end 2005 (because of the phase-out of production tax credits). There are, also, examples of RFPs from the Massachusetts Technology Council (“MTC”) that are similar to NYSERDA’s in that attributes were acquired so as to facilitate project financing.

C. THERE ARE FACTORS THAT OCCASIONALLY MIGHT DIMINISH THE VALUE OF COMPETITIVE BIDDING IN SPECIFIC CIRCUMSTANCES.

There are circumstances in which the value of competitive bidding might be diminished, or in which specific actions might be necessary to ensure that competitive bidding ultimately brings value to an electric utility and its customers. Depending on the severity of the problems encountered, there also are circumstances in which

competitive bidding processes generally would not be warranted. These issues are discussed in this section of the Consumer Advocate's Statement of Position.

1. The Urgency In Which The Resource Is Needed May Affect The Decision To Conduct A Competitive Bid Process.

Competitive bidding through RFPs can take time to implement and, while one cannot generalize very precisely, the time is months rather than weeks. This means that, for example, the near-term needs for short-term power supplies should be satisfied in other ways; similarly, where power supplies are needed to respond to an unanticipated emergency, competitive bidding will be too cumbersome.

2. System Reliability and Operational Considerations May Affect the Decision. Similarly, the Magnitude of the Current and Post Solicitation Purchases From Non-Utility Suppliers May Affect the Decision.

Electricity is an essential service. Electric utilities on the mainland typically rely on their transmission connections with other utilities, and access to a diversity of off-system generating facilities, to achieve established standards or reliability. By contrast, Hawaii's electric utilities are not connected to a larger transmission grid. They are necessarily self sufficient with respect to the level of reliability that their combined generation and transmission facilities deliver. As such, the generating units – and indeed all resources -- included in each utility's system are particularly important vis-à-vis the broader question of system reliability.

Increasing reliance on independent power producers implies that both the reliability and operational performance of Hawaii's utilities will be increasingly

determined by non-utility facilities. Thus, the contractual terms and conditions will be of particular importance. In addition, although all resource procurements now pay close attention to counter-party creditworthiness, this is even more important in the absence of the enhanced reliability associated with transmission interconnections.

At the time of PURPA's enactment, very high percentages of utility supply portfolios derived from their own generating resources. At present, HECO's March 2005 Adequacy of Supply report indicates that its 2004 total generating capability of 1,615 MW (net) includes 406 MW (net) of firm power purchased from independent power producers. This figure would increase by roughly 30 MW if HECO's application in Docket No. 04-0320 is approved, bringing non-utility supplies to just over 25 percent of its supply portfolio. The independent power facilities typically are the newer, more efficient units on HECO's system, thus their energy (i.e., megawatthour) contributions likely are a significantly larger percentage of total energy production.

The Consumer Advocate recommends that the utility address bidder qualification requirements on a case-by-case basis, applying "best practices" in the industry to set standards that must be achieved. In circumstances in which a utility believes that there are reasons not to procure resources (or any particular resource) from a third party it should present supportive evidence during the IRP proceedings. As noted above, this may be an issue whether or not competitive bidding is the procurement mechanism.

3. Impacts Of The Risks Of Procuring Energy And Capacity From Third-Party Suppliers May Affect The Decision To Pursue A Competitive Bid Process For The Procurement Of New Resources.

The acquisition of resources from the market means that the resources will be contractually bound to provide service rather than being owned and operated by the utility. Contracts will allocate risks and benefits differently than will rate base and the Commission will need to determine, if the matter is raised by a utility, whether there are significant reasons in any particular circumstance to prefer utility ownership. This is an IRP issue and will affect the acquisition of resources from non-utility providers whether or not competitive bidding is the procurement mechanism.

It is the Consumer Advocate's view that the resolution of such matters will be case-by-case. It is important to note, however, that power purchase contracts have evolved over time to better allocate risks and that, consequently, the problems associated with, for example, some of the older QF contracts have been mitigated. This is not to say that contracting for resources will always be appropriate; but it is to say that some of the problematic agreements are now inapposite.

The Consumer Advocate is confident that competitive bidding can yield significant benefits to consumers under appropriate circumstances. Where third-party suppliers are willing to provide needed resources to a utility at prices below the utility's avoided costs, consumers will benefit. Nonetheless, there are challenges. Although the Consumer Advocate recommends that there be a presumption in favor of competitive bidding as the means to acquire non-utility resources, we recognize that there may be occasions (in addition to the foregoing) in which the presumption is rebutted. Other possible factors are discussed below.

4. The Size of the Utility's Incremental Capacity Requirements May Affect the Decision.

At issue here is whether the quantity of power that would be procured is of sufficient magnitude to warrant introducing a competitive bidding procedure for power supplies and other resources from third-party suppliers. In short, there may be circumstances in which the potential cost and other benefits that might be achieved through a competitive bidding process are likely to fall short of the costs to administer a fair, effective solicitation. In such instance, going directly to the utility's alternate proposal may represent the best path for ratepayers.

Clearly, if it is an issue, it is likely to be closely related to the size of the utility. Setting aside Oahu, load and the absolute magnitudes of load growth may be very small – i.e., only a few MWs – for Hawaii's other utilities. Nonetheless, it is expected that the costs of implementing a solicitation will fall as experience grows and the RFP documents (including contracts) are only customized rather than originally drafted. In addition, even small procurements (for DSM, say, or grid-based DG) can have substantial benefits.

The Consumer Advocate believes that, because of the continuing evolution of generation technologies, there will be circumstances under which competitive bidding for relatively small load increments will be feasible. In any instance in which a utility seeks to rebut the presumption to solicit market resources, it should of course do so during the IRP process.

5. The Availability of Sites and Critical Infrastructure Could Affect the Decision.

There will be circumstances in which a utility's requirements may be addressed most cost-effectively through the acquisition of power from a central power station. In such an instance, the availability of generating sites and critical infrastructure will obviously be critical. It would be difficult to anticipate a sufficiently competitive response to an RFP if sites are in short supply or access to critical infrastructure (e.g., fuel supply facilities) is overly constrained. For example, land on Oahu appears to be a scarce resource to a degree that one would question whether potential competitors would be able to secure competing sites. Moreover, setting Oahu aside, the islands are served by relatively "thin" transmission grids that may limit the ability of developers to move power to load centers. Where smaller-scale solicitations are considered, such as may apply to renewable and CHP facilities, the site pressures will be attenuated, even if not entirely mitigated.

It should be noted that a utility could implement a competitive process to acquire non-utility generation by making one of its sites available to third parties. This evidently was the case with respect to the RFP that produced the above-mentioned KIUC facility. In such a case, the utility would provide the infrastructure (at some price), determine the type of facility required (peaker or otherwise) and seek the best bid to provide it, perhaps through a tolling agreement with the winning party.

The Consumer Advocate recommends that the question of site availability continue to be an important consideration in any decision to institute a competitive bidding process, particularly if for a central generating station. It may be sensible to implement a competitive bidding process even if there are only a few sites known to be

available, as long as the utility's back-up or contingency plan is cost-based. In the absence of real competition, the utility itself should not be able to put in a power plant bid that deviates from its expected cost.

D. CONCLUSIONS REGARDING THE FORESEEABLE BENEFITS OF COMPETITIVE BIDDING.

1. What Are The Benefits Of Competitive Bidding?

Competitive bidding represents one of several mechanisms by which a utility can “tap” competitive markets for a range of capacity and energy resources, to see if any represent a better approach than the utility would otherwise implement. As presented in Section I.D, the benefits offered by competitive bidding are restated below. Competitive bidding 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 environmental, fuel diversity and other public policy goals by removing barriers to developers with innovative resource proposals.

Competitive bidding has brought many of these benefits to Hawaii in the past. The Consumer Advocate anticipates that it can continue to do so in the future.

2. What Are The Impacts Of Competitive Bidding?

While there will be direct cost impacts associated with competitive bidding, those costs are small relative to the costs associated with the costs of the energy resources being acquired. These will come in the form of the bid documentation that will have to be produced to implement each competitive bidding process. Costs will also manifest in the efforts needed to administer and oversee each solicitation process, to conduct contract negotiations with the winning bidder or bidders, and to administer the contracts that result. Where large incremental resource needs are at issue, the Consumer Advocate observes that these direct costs likely will be quite small relative to the magnitude of the investments that will be avoided. Even where needs are of lesser magnitude, competitive bidding processes repeated within or across companies (i.e., many of the bid documents for small solicitations will be readily transferable between companies) costs likely will be manageable and diminishing with time. The direct costs associated with competitive bidding likely will pale in light of the potential benefits.

3. Should A Competitive Bidding System Be Developed For Acquiring New Capacity And Energy Resources In Hawaii?

Hawaii and its consumers deserve to share in the benefits that competitive bidding can bring. As such, the Commission should make clear that it is the policy of the Commission that competitive bidding be implemented by the utilities in all energy resource acquisitions, unless there are clear reasons to do otherwise. As is discussed in the Section that follows, the changes in Commission's rules necessary to achieve this result are limited. In somewhat simplified terms, the Commission could indicate that

jurisdictional electric utilities (1) are expected to implement competitive bidding in meeting their resource needs, unless there is strong reason for not doing so, and (2) will be held accountable for conducting proper and fair competitive solicitations. Once a decision is made to implement competitive bidding (e.g., as a consequence of stakeholder agreement and Commission authorization in an IRP process), there is no regulatory “system” needed for its implementation. Indeed, Hawaii’s utilities have already shown that effective competitive bidding processes can be implemented without such a system.

For reasons discussed in greater detail in the following section, the Consumer Advocate believes that developing an extensive set of rules is not the best way to implement competitive bidding in Hawaii. However, the Consumer Advocate contends that the benefits from competitive bidding likely will be enhanced if the Commission sets a solid foundation for competitive bidding in Hawaii. This would involve some limited amendments to the Commission’s IRP Rules. In Section III that follows, the Consumer Advocate presents its recommendation on the sequence of actions that the Commission should undertake to set a solid foundation for competitive bidding.

III. HOW TO IMPLEMENT COMPETITIVE BIDDING IN HAWAII.

The preceding discussion presents the basis for the Consumer Advocate’s position that competitive bidding should be implemented by the utilities in Hawaii as the primary means to implement their IRPs. This Section provides the Consumer Advocate’s view of how competitive bidding should be implemented in Hawaii.

The Consumer Advocate emphasizes that competitive bidding can be implemented within the Commission current regulations. Ratepayers need not await the outcome of further regulatory process before they can begin to enjoy the benefits of competitive bidding. The electric utilities and their affiliates have experience (in varying degrees) with competitive bidding, as discussed in Section I.C.7. above. That prior experience, perhaps with input from industry experts in the design and implementation of competitive bidding processes (e.g., Merrimack Energy Group consultants offered HECO's comments in the September 28, 2004 workshop),²⁴ can be utilized by the utilities today within the current IRP framework.

The Consumer Advocate contends that developing an extensive set of rules is not the best way to implement competitive bidding in Hawaii. First, we note that at least some state public utility commissions that routinely implement competitive bidding have no rules specific to competitive bidding processes themselves. Rather, their rules are similar in structure and intent to the Commission's existing IRP Rules, which merely establish a necessary context for resource planning and procurement generally.

Second, the Consumer Advocate thinks that it is a mistake to establish a specific set of rules governing competitive bidding processes. Competitive solicitations will necessarily vary depending on the size of the company involved, the size of the resource need, the nature of the resources being sought, and so forth. Moreover, "best practices" in resource solicitation also can be expected to evolve over time. Accordingly, the Consumer Advocate recommends only that the Commission require electric utilities to (1) implement "best practices" that are appropriate to each

²⁴ Presentation of Wayne Oliver, Merrimack Energy Group, Workshop on Competitive Bidding, Docket No. 03-0372, September 28, 2004.

competitive bidding process that they administer, and (2) be prepared to demonstrate, during and after each solicitation process, that they have met this requirement.

Nonetheless, the Consumer Advocate believes that the benefits of competitive bidding will be enhanced if the Commission sets a solid foundation for its effective implementation in Hawaii. This Section presents the Consumer Advocate's recommendations regarding the actions needed to implement a competitive bid process for the acquisition of new resources. In summary, the Consumer Advocate recommends the following:

- The Commission should establish 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 which is consistent with all-source competitive bidding.
- The Commission should amend its IRP Rules to enhance the benefits of competitive bidding by 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-a-vis its own competitive bidding process; and
- The Commission should identify the Commission review processes that would apply to a successful bidder.

These recommendations are explained in more detail in the Sections that follow.

A. THE COMMISSION SHOULD ESTABLISH COMPETITIVE BIDDING AS THE MECHANISM BY WHICH NEW CAPACITY AND ENERGY RESOURCES WILL BE PROCURED IN HAWAII.

Competitive bidding should be the default approach to securing new resources. The Consumer Advocate recommends that the Commission establish a rebuttable presumption that competitive bidding will be implemented to address the incremental resource needs of all jurisdictional utilities. This recommendation derives from the fact that, as noted in Section II of this statement, whenever energy resources are needed by regulated utilities competitive bidding, or some comparable form of competitive test, should be the basic expectation.

The Consumer Advocate recognizes that competitive bidding cannot be established as an immutable requirement, because there will be circumstances in which competitive bidding may not be practical. Accordingly, where a utility (or any party) can demonstrate that competitive bidding would be contrary to the public interest, the Commission should be presented with and should consider alternate approaches.

B. THE COMMISSION SHOULD RECOGNIZE THAT COMPETITIVE BIDDING BELONGS AS AN INTEGRAL PART OF ITS IRP FRAMEWORK.

Competitive bidding must be instituted as an integral part of the Commission's IRP Framework. As is presented in Section I above, competitive bidding is an effective mechanism for procuring resources where complex decision criteria are present. Moreover, competitive bidding can be used to elicit a broad range of resource options in response to specific identified needs. As such, it is ideally suited for the implementation phase of the IRP cycle, during which electric utilities carry out the action plans that have

been approved by the Commission as part of the IRP. Competitive bidding is the means by which least-cost, high value objectives for resource procurement can ultimately be realized.

The Consumer Advocate anticipates that some might question this view of when, in the IRP process, competitive bidding processes would take place. However, the Consumer Advocate's view here is similar to the Option 1 approach advanced by HECO in the September 2004 workshops.²⁵ The essential question is: *Should competitive bidding be conducted before, during or after its "plan" is reviewed and approved?*

Decision and Order No. 11630 (May 1992) which establishes the Commission's IRP Framework states, at 9, that "An integrated resource plan is ... intended to 'control, direct, or strongly influence' all power purchases." Competitive bidding processes are, at their core, mechanisms for procuring resources. Therefore, as a general matter, the Consumer Advocate finds it both appropriate and consistent with the IRP Framework that competitive bidding be implemented as a mechanism to secure resources that have been broadly identified and approved in a utility's resource plan. The subsequent RFP process, of course, would ultimately identify the resources precisely.

The Consumer Advocate cannot support the notion that competitive bidding be utilized for purposes of identifying -- in advance of an IRP planning process -- resources for possible inclusion in a utility's resource plan. Certainly there is merit in entering a planning process with as much information as possible about the resources likely to be available to a utility in crafting a response to identified resource needs. However,

²⁵ See pages 23 – 24 of the Presentation of Wayne Oliver, Merrimac Energy Group, Workshop on Competitive Bidding, Docket No. 03-0372, September 28, 2004.

competitive bidding processes in a commercial setting should not be utilized in this manner.

The reasons for this derive from the Consumer Advocate's view that competitive bidding is a procurement method. Moreover, preparing a quality proposal requires considerable time and expense on the part of a project proponent. In the absence of any reasonable expectation that a proposal will result in a contract with the utility, it is unlikely that resource providers would provide more than a limited statement of interest, if that. This will not yield a solid assessment of the available resources, their prices, the creditworthiness of the providers, and so on. In other words, and perhaps ironically, an informational-only solicitation is unlikely to result in sufficient useful information to make it worthwhile. By contrast, the history with competitive bidding shows that, when utilities issue an RFP where bidders have confidence that a commercial contract will result, they will submit bona fide proposals – sometimes in considerable number.

Accordingly, the Consumer Advocate recommends the following sequence of IRP activities that would lead to implementation of a competitive bidding process. A utility would:

- Identify its need for incremental resources. See, e.g., IRP Rules, Parts III.A.1 & III.D.1.a. In this initial step the utility would develop forecasts of load and anticipated contributions from existing and committed resources, so as to identify its need for additional capacity resources. The identification of need also would encompass analysis of the factors that affect key objectives to be achieved through its resource portfolio; these would include consideration of system security, fuel diversity, renewables penetration, rate objectives, etc.
- Describe its proposed incremental resources. See, e.g., IRP Rules, Parts III.A.1 & III.D.1.a. The utility would develop a proposed response to its identified needs, describing the nature of the resources that it expects might be the best response to those

needs. In essence, the utility would complete the statement, “Given our existing resource mix and the key objectives that we are seeking to achieve through our resource portfolio, here is what we think we need to pursue through our IRP Implementation Plan...”. The utility should identify where, if at all, it thinks that competitive bidding would not be appropriate for acquiring energy resources needed. Also, at this juncture the utility would describe the “backstops” (e.g., “avoided units”) that it would implement if market solicitations do not produce the requisite resources.²⁶ The “backstop” would be the action identified in the IRP and would, in essence, serve as the utility’s contingency plan should the competitive bid process not be successful. Furthermore, the utility’s “backstop” proposal would essentially become the utility’s “bid” in the competitive bidding process.

- Initiate the Stakeholder (i.e., “public participation”) process. See, e.g., IRP Rules, Part III.E. Stakeholders can address the utility’s IRP in a meaningful way once they have been provided a detailed review of its needs, its proposed resources, and the mechanisms by which it proposes to procure those resources. Stakeholder inputs might result in modifications to any of these three items.
- Submit its Integrated Resource Plan to the Commission. See, e.g., IRP Rules, Part III.D. This phase of the process would incorporate the Commission’s review of the utility’s IRP proposal (including its needs assessment, proposed resources and proposed procurement strategies). The Commission would approve or modify its proposal, as appropriate, at the end of the public review process.
- Implement Competitive Bidding Processes. See, e.g., IRP Rules, Part III.A.3. The utility would implement the procurement strategies (presumptively competitive bidding) approved by the Commission. Once the utility has obtained Commission approval of its needs and its proposed resources and procurement strategies, the Commission would instruct the utility to implement any competitive bidding processes according to “best practices,” which might unfold as follows:
 - The utility designs (possibly with help from industry experts) its solicitation process, establishes evaluation criteria

²⁶

At this juncture, the utility could describe any objections to the use of competitive bidding for acquiring any elements of its identified needs. It is presumed that the utility would utilize competitive bidding to procure its resources unless it can provide the Commission with justification for alternative approaches.

- consistent with its overall IRP objectives, and specifies the timelines for the process;
- The utility develops (possibly with help from industry experts) the bid package that would be issued, which might include an initial notice, the RFP itself, sample contract for comment, additional supporting materials (such as documents specifying its approved needs), etc.;
 - The utility may or may not submit its solicitation design and bid package to the Commission for review and approval, depending on agreements with stakeholders and/or prior Commission rulings;
 - The utility implements its RFP (possibly under oversight of an independent evaluator, depending on circumstances) and obtains bids;
 - The Commission resolves any disputes that arise between the utility and bidders, or among bidders (an effective RFP design and bid package will serve to keep bona fide complaints to a minimum);
 - The utility applies its bid evaluation criteria and selects a winning bidder (or bidders). Negotiations to finalize a contract(s) would ensue; and
 - The utility submits the resultant contract(s) to the Commission for approval and rate treatment.
- Be prepared to modify its IRP Implementation Plan. See, e.g., IRP Rules, Parts III.D.4, IV.F & IV.I. The utility's IRP Implementation Plan cannot be cast in stone. The utility should be prepared with well-considered contingency plans to address those circumstances in which its planned procurements do not proceed as anticipated. The utility must be prepared to document and defend any modifications to its IRP as necessary and consistent with prudent management of its resource portfolio. The Commission must act to ensure that this necessary measure of discretion is not abused by the utility.

The Consumer Advocate believes these changes can be implemented within the current rules and asks the Commission to include this understanding in an Order in this proceeding. As is discussed below, the Consumer Advocate is recommending that the

IRP Rules be enhanced to enable stakeholders to play a more meaningful role in helping to shape a consensus regarding an electric utility's needs, the resources that would best respond to identified needs, and the appropriate procurements strategies for such resources. The goal would be to ensure that those engaging the "Public Participation" portion of an electric utility's IRP proceeding (pursuant to Part III.E of the Commission's IRP Rules) would have available all information discussed in Parts III.A.1 and III.D of the Commission's IRP Rules.

C. THE COMMISSION SHOULD ADOPT A METHOD FOR DETERMINING AVOIDED COST THAT IS CONSISTENT WITH ALL-SOURCE COMPETITIVE BIDDING.

In implementing a competitive bidding policy, the Commission should establish competitive bidding as the basis for establishing avoided costs in Hawaii, where the acquisition of long-term contracts is at issue. Once the Commission has adopted competitive bidding as its preferred approach to resource procurement, the electric utilities should incorporate competitive pricing principles into their PURPA contracts and other resource acquisition activities. To bring benefits to Hawaii and its consumers, the Commission should follow other states in establishing (as a matter of policy) that competitive processes will define what is "avoided," and thus that pricing for long-term contracts should be consistent with the actual results of competitive processes.

D. THE COMMISSION SHOULD AMEND ITS IRP RULES TO ENHANCE THE BENEFITS OF COMPETITIVE BIDDING BY IMPROVING THE INFORMATION AVAILABLE TO STAKEHOLDERS IN DECIDING AMONG ALTERNATE PROCUREMENT STRATEGIES.

The Consumer Advocate recommends that the Commission implement two revisions to its IRP rules to improve the foundation for competitive bidding. Both revisions are intended to allow the Consumer Advocate and other stakeholders to play a meaningful role in electric utility planning and procurement processes.

First, the Commission must make clear that utilities are required to provide stakeholders with detailed information regarding their needs at the outset of the “public participation” phase of the IRP review. The information that should be provided is described below.

Ensure That Stakeholders Receive Sufficient Information At The Outset

The Commission’s IRP Rules should prescribe that each electric utility’s IRP report to stakeholders at the start of the “Public Participation” phase of the proceedings must include all items listed in Section III.D.1.a of the Commission’s IRP Rules, and the following:

- a 20-year load and energy forecast;
- a summary of the capability (MWs) of its generating units and purchased power acquisitions across the 20-year forecast period;
- a unit-by-unit forecast of the production costs of each generating facility;
- a statement of the utility’s generating unit reliability planning criteria;
- an assessment of need for additional resources (either for reliability purposes or, to replace resources that are no longer cost effective);
- a discussion of the transmission and distribution upgrades expected to be necessary (e.g., to support growing customer loads) during the planning period;

- a description of the “non-price” planning criteria that the utility proposes to consider in evaluating resource options, with sufficient background information (i.e., history and projected trends) to justify each. This presentation would include the quantifiable measures by which the utility will determine whether its non-price objectives are fulfilled through implementation of its resource plan;
- a detailed description of the “backstop” resources by which the utility would meet its service obligations, absent other options; and
- a description of the RFPs that it would propose to issue to seek market responses to identified needs.

The Commission’s IRP Rules should prescribe that each utility’s annual evaluation report pursuant to Part III.D.3 of the IRP Rules must include sufficient detail regarding each of the above to assess the ongoing validity of any approved IRP Implementation Plan. This will enable stakeholders to play a meaningful role in helping to shape a consensus regarding an electric utility’s need, resources that are responsive to identified needs, and appropriate resource procurement strategies (i.e., within an approved Implementation Plan). The Consumer Advocate’s goal is to ensure that those engaging the “Public Participation” portion of an electric utility’s IRP proceeding (pursuant to Part III.E of the Commission’s IRP Rules) have available all information discussed in Parts III.A.1 & III.D of the Commission’s IRP Rules.

The Consumer Advocate also recommends amendments to the IRP rules to improve the overall timing of resource planning review cycles. The Consumer Advocate has found it extremely difficult for it to play a meaningful role in the review of utility resource planning and procurement activities. This is due in part to the attenuated nature of the review cycles, which seems to precipitate unforeseen needs²⁷ and utility

²⁷ HECO’s March 2005 Adequacy of Supply report announces several changes in its circumstances that impact the adequacy of supply on Oahu, and reserve capacity shortfalls beginning in 2005 and lasting through at least 2009.

procurements outside of any IRP review process.²⁸ With these objectives in mind, the Consumer Advocate recommends the following specific modifications to the Commission's IRP Rules:

Improve The Timing of IRP Cycles

With respect to the timing of the IRP cycles, the Commission should:

- State its intent to require utilities to meet Section III.B of its IRP Rules, such that each utility should conduct a “major review” of its IRP every three years.
- Prescribe that each electric utility must file every three years, for approval, a 20 year integrated resource plan. That 20-year plan filing should also include a 5-year Implementation Plan.
- State its intent to review expeditiously electric utility IRP filings, to promote effective, consensual decision-making in response to Hawaii's challenging resource needs.
- Prescribe that each electric utility must file an annual update to its 5-year Implementation Plan.
- Make clear that a utility's approved Implementation Plan is not immutable. Rather, changes should be made as the utility's circumstances change (and as described in annual updates to the Adequacy of Supply reports). However, any proposed changes resource procurements described in an approved 5-year Implementation Plan must be documented by the utility and approved by the Commission.
- Make clear that any resource procurements outside of an approved Implementation Plan must meet a two-pronged test if cost-recovery is to be approved. The utility must demonstrate that the procurement will (1) yield substantial benefits relative to alternate resource options and (2) cannot be delayed to the next IRP cycle.
- Prescribe that, on its own motion or motion of any party, the Commission may at any time elect to initiate a formal review of a utility's IRP Implementation Plan, based on information provided in

²⁸ The Consumer Advocate recently introduced its concerns over utility acquisitions occurring largely outside of IRP processes in its Statements of Position in Docket Nos. 04-0346 and 04-0365.

an annual Adequacy of Supply Report (or otherwise), and issue orders requiring modifications to any aspect of the IRP Implementation Plan (including requiring that an RFP for new supplies be filed by the utility), and approving, rejecting, or requiring modifications to any proposed RFP.

Finally, the Consumer Advocate recommends changes to the Commission's IRP rules to establish a clear link between a utility's integrated resource planning and procurement processes and the facilities for which it seeks preapproval of capital investments under General Order No. 7, Paragraph 2.3(g)2. The Consumer Advocate is concerned that past practice has resulted in some facilities coming before the Commission that have not received sufficient consideration relative to competing resource alternatives. The Consumer Advocate has recommended to the Commission (see Decision and Order No. 21001, May 2004, at 10) that the IRP process provides an effective means by which to evaluate utility needs for capital expenditures. However, that opportunity is lost if ignored by the utilities. The IRP rules amendment recommended below would help remedy the problem.

Other:

The Consumer Advocate recommends that the IRP Rules be amended to make explicit the following:

The process by which utilities gain preapproval of capital improvements in excess of \$2,500,000 should be amended to place upon an applicant the legal burden to demonstrate that a proposed electric generation project is consistent with its most recently approved IRP annual update.

F. THE COMMISSION SHOULD ESTABLISH ITS CRITICAL OVERSIGHT ROLE REGARDING COMPETITIVE BIDDING PRACTICES.

Achieving optimal results through competitive bidding processes requires, above all else, that resource solicitation processes be truly competitive. This means that each respondent must expect to be judged solely on the merits of its proposal relative to the product or service being requested. The Consumer Advocate offers the following recommendations to ensure that competitive bidding in Hawaii achieves optimal results:

- The Commission’s oversight role is critical to ensure the integrity of competitive bidding processes. If the Commission determines to implement competitive bidding processes, it will fall upon the Commission (and, to a degree, the Consumer advocate) to ensure that competitive bidding processes are conducted in a manner that assures a fair competitive solicitation, both in actuality and in appearance (*i.e.*, by implementing the various recommended actions described in this subsection and throughout Section III). In some circumstances, particularly those in which the utility or a subsidiary intend to submit proposals, this may require the use of an outside observer, as is discussed further below.
- The Commission should ensure that “best practices”²⁹ are adopted for competitive bidding. The appropriate approach to designing and implementing competitive bidding will vary depending on the utility and resources being procured. The issues facing KIUC in issuing an RFP likely will be different from those facing HECO. Similarly, an RFP for baseload generation might look very different from an RFP for wind facilities or demand-side programs. Moreover, competitive bidding design and implementation methods can be expected to improve with time and as the utilities gain experience. Rather than attempt to cast a “one size fits all” approach in this proceeding, the Commission should indicate its expectations that “best practices” appropriate to the circumstances will be adopted in each instance. The utility will be responsible for employing practices that it can defend to stakeholders and the Commission, as appropriate.

²⁹

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 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.

- Transparency in the process is critical. While a “transparency” requirement almost certainly falls 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 the bid evaluation processes are understood by bidders and other external parties and the role of the utility or its affiliates as a participant in the bidding process is clear to all and at arms length from the evaluation of the bids. The Commission should ensure that a utility’s RFP design and bid package materials are developed in a manner that will ensure an appropriate measure of transparency. See the discussion below of FERC’s Order in 108 FERC ¶ 61,081.
- A commercial contract should result. Utilities should expect to consummate a commercial contract with winning bidders. There is substantial experience in the industry regarding acceptable commercial agreements (e.g., that a successful bidder can use to secure financing) for certain types of transactions. For example, the last 20 years have seen enough power purchase agreements drafted that much of the contract language has become quite well known, although there is no one standard agreement that will work in all circumstances.
- Create linkages between a utility’s earned return and its performance in implementing competitive bidding. If a utility can demonstrate that it is doing a particularly good job in resource procurement, the Commission should consider an increase to its allowed return. Conversely, poor performance will require the consideration of a reduction.

G. 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.”

It is not possible to be effective in prescribing, in advance as a general rule, the bidding processes that will most benefit Hawaii and its consumers for each solicitation. Rather, optimal bidding processes will evolve and will vary, depending on the nature of

a utility's needs and its specific circumstances. Across the last several decades, a considerable base of experience in the design and implementation of competitive bidding processes has been developed. The Consumer Advocate recommends that the Commission adopt a flexible approach to competitive bidding that taps this base of experience, as necessary, to extract the "best practices" in the industry. Each electric utility should be expected to implement any approved competitive bidding process in a manner appropriate to its needs and circumstances, consistent with "best practices."

There are a number of documents generally available that provide insight into approaches that can be implemented in response to utility needs of different types. We attach several of these as further Appendices to the Consumer Advocate's Initial Statement of Position, as follows:

- Appendix 1 contains a 1992 Guidebook published by Central Maine Power entitled New Energy: CMP Resource Needs and Acquisition Procedures.
- Appendix 2 contains Portland General Electric Company's January 2004 report on its IRP Action Plan, which describes both the action plan and resource solicitation processes.
- Appendix 3 contains the Merrimack Energy Group's September 2004 report as an independent auditor of Portland General Electric Company's RFP for power supply resources.

H. THE COMMISSION SHOULD DEFINE ROLE OF HOST UTILITY VIS-À-VIS ITS OWN COMPETITIVE BIDDING PROCESS.

The Consumer Advocate sees it as critical that the Commission resolve the role that electric utilities (and their affiliates) will play in their own competitive bidding processes. Competitive solicitations – in any industry or market – will be problematic if potential bidders believe that the evaluation process is skewed in favor of any entity. It

is particularly problematic if the ostensible purchaser submits its own bid to provide the product. In the electric utility business, the problem has been mitigated by requiring that “utility” bids come from their subsidiaries or so-called sister companies (where a holding company is involved). If the utility itself is to both bid and evaluate the bids, the Consumer Advocate strongly recommends an outside observer, whenever feasible. This position is taken, it should be stressed, not because there is any a priori reason to suspect problematic behavior. To the contrary, it is taken because even the perception of a conflict of interest may be sufficient to chill the market, with obvious consequences.

Because the Renewable Energy Hawaii, Inc., (again, an HEI company affiliated with HECO, HELCO, and MECO) is conducting competitive solicitations for renewable energy projects with the intention of being an investor in those projects and selling output to the utilities, this issue is of particular importance.

FERC guidelines for competitive solicitations when affiliate transactions are involved are applicable to this situation. The following excerpt from a recent FERC order is a synopsis of the principles applies in competitive bid situations including affiliates that fall under FERC’s jurisdiction:³⁰

The fundamental objective of the solicitation guidelines is that the affiliate should have no undue advantage over non-affiliates in the solicitation process. Adhering to the guidelines will ensure that wholesale customers receive the benefit of the marketplace, including an unbiased assessment of the full range of choices, whether the soliciting utility provides service at cost- or market-based rates. Paragraph 69.

³⁰ Cited text appears on page 25 of Opinion and Order Affirming Initial Decision in Part, Denying Requests for Rehearing and Announcing New Guidelines for Evaluating Section 203 Affiliate Transactions, Opinion No. 473, Docket Nos. EC03-53-000 and EC03-53-001 (108 FERC ¶ 61,081). FERC includes added discussion of these principles in this order beginning on page 26. We note that this order pertains to transactions of generation assets, however, the principles are based on FERC actions that pertain to power contracts, as well, most notably the *Edgar* decision cited in this order.

The solicitation guidelines have four principles:

- **Transparency:** the competitive solicitation process should be open and fair.
- **Definition:** the product or products sought through the competitive solicitation should be precisely defined.
- **Evaluation:** evaluation criteria should be standardized and applied equally to all bids and bidders
- **Oversight:** an independent third party should design the solicitation administer bidding, and evaluate bids prior to the company's selection. Paragraph 70.

Complicating the situation is the fact that Hawaii's electric utilities have an obligation to serve, which extends to ensuring that they can implement plans that provide their customers with access to a reliable supply of electricity "if all else fails." The Consumer Advocate does not take lightly the responsibility of electric utilities to plan for, and respond to, contingencies that might affect reliability on their systems.

All-in-all, the Consumer Advocate can support the proposition that a utility may submit a bid in its own solicitation, as long as the following guidelines are implemented:

- Where there are or can be competitive markets in which independent, third party providers can be tapped to obtain needed capacity and energy resources, utilities should avail themselves of those markets – unless there is some clear reason for expecting that the utility can better achieve its planning objectives (including cost minimization, etc.) without competitive bidding.
- In considering competitive bidding, a utility must fully evaluate the costs of directly providing a needed resource (i.e., absent competitive bidding from third-party providers). Only thus will the Commission and stakeholders have a view of the benefits actually achieved through a given competitive bidding process. That is, where bid prices fall below the utility's costs, price benefits will result. If bid prices are not below the utility's costs, presumably the Commission would want to see strong evidence of "non-price" benefits in the competitively procured resource before approving any resulting contract. In the absence of demonstrable benefits

from an RFP, the Commission may determine to direct the utility to proceed with developing its avoided unit.

- When competitive bidding is to be implemented, an electric utility must anticipate that the process may fail, and thus must be prepared with a “backstop” plan (i.e., the specific resources that the utility would develop and put into ratebase if necessary to meet its service obligations). This backstop plan may be satisfied by the utility’s resource proposal(s) (see above).
- If a utility is allowed to compete directly in its own RFP (i.e., to offer a proposal that is compared against those of other bidders), in addition to incorporating stringent rules to protect against self-dealing in the design and implementation of its RFP, the utility’s proposal must be held the same performance, creditworthiness, and other evaluation standards as are applied to other bidders. This applies equally to any “avoided” resource that might set a threshold price in a competitive bid, thereby implicitly joining the solicitation. In addition, where a utility (or a related company) intends to submit one or more bids, the Commission should determine whether an outside observer is required.
- If a utility is allowed to compete directly in its own RFP, the utility should be held to cost-based ratemaking (e.g., the traditional approach to ratebasing self-built generation facilities). Important ratepayer benefits will be lost if utilities that may enjoy a competitive advantage (for whatever reason) over third-party providers are permitted to price up to market.
- If a utility is allowed to compete directly in its own RFP, the utility also should be held to terms that are consistent with the contractual terms (such as availability) to which it would have held a third party supplier acquired through the RFP. Otherwise, a utility’s proposal will enjoy unfair advantages in the RFP.
- If a utility is allowed to compete directly in its own RFP, the Commission should evaluate whether or not there is any reason to take action (perhaps through special rules), to ensure that the utility is not even perceived to be in a position to unduly influence the results of the solicitation.

I. THE COMMISSION SHOULD IDENTIFY THE COMMISSION REVIEW PROCESSES THAT WOULD APPLY TO A SUCCESSFUL BIDDER.

The Consumer Advocate anticipates that the contract review processes that would apply to contracts secured by winning bidders in an RFP issued as part of an approved competitive bidding process in an IRP would be the same as the Commission currently applies to contracts between electric utilities and third-party power suppliers. However, the Commission should make explicit its intentions in this regard, in part to minimize risks (real or perceived) to bidders that might adversely impact costs to ratepayers. Similarly, the Commission should make explicit that costs would be recoverable through rates on a “pass-through” basis, if incurred through an approved contract that results from RFP issued in response to approved competitive bidding process.

J. CONCLUSIONS.

In its Decision and Order No. 20923, the Commission identified the issues for this docket. This Section III of the Consumer Advocate’s Statement of Position provides specific recommendations to the Commission, in response to the following questions:

(2)a. How can a fair competitive bidding system be developed that ensures that competitive benefits result from the system and ratepayers are not placed at undue risk?

The Commission can readily establish a fair competitive bidding system in Hawaii. There are numerous examples of fair competitive bidding systems that have been successfully employed in other states that attest the ability to do this and provide guidance on how this can be done. In light of the fact that the HEI Companies have an

affiliate company active in the development of renewable projects, the Commission should define clearly the role that it will allow a host utility and its affiliates to play in competitive bidding processes and assure that the bid design, implementation, and evaluation are conducted independently from the project development interests of the utilities and their affiliates. The Commission should also establish an oversight function for the bid process.

If the Commission establishes a fair system, customers will clearly benefit. As noted above, the incremental cost to implement such a system is small compared to even small improvements in the cost of energy supplies. From a cost perspective, there is very little to lose relative to the significant potential gain.

With respect to risk that may result, which the Consumer Advocate presumes refers to reliability concerns, care in the conduct of planning studies and in designing contracts will mitigate those risks as they have in other situations where PURPA and IPP contracts have been critical to reliability. In addition, we propose the utilities' IRP processes include specific "backstop" plans in the event suitable proposals are not forthcoming.

(2)b. What are the specific competitive bidding guidelines and requirements for prospective bidders, including the evaluation system to be used and the process for evaluation and selection?

The Consumer Advocate recommends that the Commission establish a policy that requires utilities to implement competitive bidding in all significant energy resource acquisitions. Because the needs identified and the types of resources solicited can vary significantly from one solicitation to the next, we recommend against specific bidding

guidelines or bidder requirements be adopted as a matter of policy. Rather, the utilities should be accountable to design and conduct specific solicitations consistent with the “best practices” in the industry.

By way of example, bidder requirements in a solicitation seeking proposals to enhance system reliability may differ significantly from bidder requirements in a solicitation seeking renewable energy to meet RPS requirements. The evaluation criteria in those situations may differ materially, as well.

The Consumer Advocate proposes that the Commission require the utilities to identify needs through the IRP process and then propose a competitive bid design to the Commission which is (1) tailored to the specifics of that solicitation, (2) consistent with criteria resulting from the IRP process, and (3) consistent with the established competitive bidding best practice. With respect to best practice, the utilities and their consultants have access to a substantial body of experience in the U.S., which can serve to establish a bid process that has proven to be successful elsewhere. In addition, the oversight function of the Commission and other parties will provide opportunity for review of the specific design of each solicitation.

With respect to evaluation standards, the Consumer Advocate recommends that the current avoided cost approach be replaced with a standard that determines the lowest cost among the competing alternatives. The specific evaluation criteria addressing tradeoffs between least cost, environmental impact, renewable energy, and reliability should be established in the design of each solicitation based on the overall IRP objectives that the solicitation is seeking to address.

(2)c. How can a fair competitive bidding system encourage broad participation from a range of prospective bidders?

First, it is important to emphasize that the competitive bidding process must be fair in both appearance and in fact in order to encourage broad participation. Please refer to the Consumer Advocate's views on fair competitive bidding in the response to question (2)a above.

Second, it is important for the competitive bidding process to be transparent to "the market" and that the requirements be well communicated. As described in Section III of this document, the bid documents should be as clear as possible with respect to the need, the contract terms, the evaluation criteria and process, and the other considerations that will be required to successfully secure a contract and complete an energy project.

Finally, it is important that there be good and timely communication with the market. The Consumer Advocate believes there is substantial evidence of a large community of prospective bidders for a broad range of projects. The IRP and bidding process must be conducted and communicated in a manner that assures that this community of prospective bidders knows how and when to participate. In this regard, two examples of materials prepared by utilities that conducted this communication to the market are included as Appendices 1 and 2.

(3) What revisions should be made to the integrated resource planning process?

The Consumer Advocate's recommendations for amendments to enhance the Commission's IRP Rules are as described in Section III.D, above.

This concludes the discussion in the Consumer Advocate's Statement of Position in the instant proceeding.

DATED: Honolulu, Hawaii, March 14, 2005.

Respectfully submitted,

By _____
JOHN E. COLE
Executive Director
DIVISION OF CONSUMER ADVOCACY

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing **DIVISION OF CONSUMER ADVOCACY'S STATEMENT OF POSITION AND APPENDICES 1 THROUGH 3** were 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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DATED: Honolulu, Hawaii, March 14, 2005.