

THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF HAWAII

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

STATEMENT OF POSITION

EXHIBITS A - E

AND

CERTIFICATE OF SERVICE

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PUBLIC UTILITIES
COMMISSION

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BEFORE THE PUBLIC UTILITIES COMMISSION

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STATEMENT OF POSITION

Hawaiian Electric Company, Inc. (“HECO”), Maui Electric Company, Limited (“MECO”), and Hawaii Electric Light Company, Inc. (“HELCO”) (HECO, HELCO and MECO are collectively referred to as the “HECO Companies”) respectfully submit their Statement of Position, pursuant to Prehearing Order No. 20923, issued April 23, 2004, as modified by Order No. 21575, filed January 28, 2005, in Docket No. 03-0372.

I. SUMMARY OF POSITION

The key issues in this docket are (1) whether Hawaii electric utilities should implement competitive bidding for new generation, (2) what competitive bidding process, if any, should be implemented, (3) which resources should be subject to the competitive bidding process (since there are significant differences between central station firm capacity, distributed generation, and as-available renewable energy generation), (4) how should competitive bidding procedures be developed, and (5) how should such a competitive bidding process be “integrated” with the integrated resource planning (“IRP”) process? The questions are not independent. (For example, competitive bidding using the wrong competitive bidding process should not be

implemented.) Moreover, the answers to the questions may not be the same for each type of resource.

It would be a mistake to focus only on the “concept” of competitive bidding in this docket. Most of the parties can hypothecate that competitive bidding will be beneficial, but there are practical realities that could make certain forms of competitive bidding detrimental in practice.

The HECO Companies can support competitive bidding for certain forms of new generation, but only if it is structured in such a fashion that the potential benefits can be realized, and the potential disadvantages can be mitigated or eliminated, and that appropriate exceptions are recognized.

A “conceptually-sound” process that works on the mainland, but ignores Hawaii’s unique reality, could result in substantial harm to Hawaii’s electric infrastructure, to the ability of Hawaii’s electric utilities to meet the growing electricity needs of their customers, and to Hawaii’s economy. The devil is in the details. The pros and cons of competitive bidding definitely will depend on the type of competitive bidding process implemented. Just as importantly, the process must provide for exceptions if implementing the process could negatively impact the ability of Hawaii’s electric utilities to add generation in a timely fashion.

The implementation of competitive bidding cannot be allowed to negatively impact the reliability of the electric utility system. The Hawaiian Islands have no interconnections with other islands, and certainly are not interconnected with large mainland electric utility systems. If it takes 8 to 12 months to complete this proceeding, 12 to 24 months to approve a new competitive bidding process, 4 to 8 months to initially implement the process, and seven years or more to obtain environmental review of, and permits and approvals for, and to acquire the

equipment for and install, the new generation, then it would be imprudent to apply the new process to generation that has to be added earlier than that (or an expedited interim process may have to be used for generation that needs to be added sooner).

In addition, it simply is not possible to precisely forecast what the future will look like ten years from now. Loads may grow faster than expected, the utilities may be unsuccessful in achieving the implementation rates that they have forecast for demand-side options, or other factors may accelerate the need for new generation. Just as IRP has to allow for the implementation of contingency options when planning assumptions and forecasts change, any competitive bidding process would have to allow for similar exceptions.

Further, the competitive procurement process for distributed generation (“DG”) may be different than the competitive procurement process for generation that provides power directly to the utility or sells power to the utility. The competitive procurement procedure that the HECO Companies propose to use for combined heat and power (“CHP”) systems that are installed at customer sites was detailed in the generic DG investigation, Docket No. 03-0371.

Also, as-available renewable energy generation has different characteristics than firm capacity, and the timing of when such resources are added to the utility’s system is not nearly as important to the reliability of the system. It may be appropriate to establish a separate competitive procurement process to acquire as-available renewable energy generation, particularly given state energy policy that favors the development of renewable energy generation.

Hawaii Specific Factors Must Be Considered

This docket was initiated at the close of the competition docket, in which the Commission determined that retail competition would not be appropriate for Hawaii, given

certain factors that are unique to Hawaii and which distinguish Hawaii from the mainland. Those same unique factors and differences must be taken into consideration in determining whether and how to implement competitive bidding, which is a form of wholesale competition.

Hawaii specific factors that must be taken into consideration include (1) the very limited number of sites that are available to site new generation, and the difficult, time-consuming and uncertain process that must be followed to change land use designations in Hawaii in order to acquire new sites for generation, (2) the extended time that must be allotted to conduct the necessary environmental review for, and to permit and obtain the necessary approvals for, new generation, (3) the utility and island-specific constraints that constrain the size of new generation that can be added to the systems, and (4) the limited fuel options that are economically available in Hawaii.

For example, HECO currently estimates that it will take seven years to obtain environmental review of, and air and other permits and approvals for, and to acquire the equipment for and install, a simple-cycle combustion turbine, at a site already zoned to allow for the installation of a generating unit, and in an area where larger power plants already exist.

In order to accommodate the addition of as-available renewable energy resources into a small, isolated island system, Hawaii utilities must carefully assess the types and mix of other resources added to its system. For example, other generating resources should be dispatchable down to minimum operating levels, and be able to cycle on and off on a daily basis so that they are off at the time of the system minimum peaks during the middle of the night. Moreover, there may be practical limits on the amount of purchased power that a utility can practically integrate into an island system. These factors would have to be considered in any competitive bidding process.

Competitive Alternatives

In order to determine the benefits and disadvantages of competitive bidding for new generation, it must first be determined what forms of competitive bidding can be and have been implemented, and what the alternatives to competitive bidding are.

Before the adoption of the Public Utility Regulatory Policies Act of 1978 ("PURPA"), utilities generally owned their own generation (either directly, or in some circumstances on the mainland, through affiliates so that larger generating units could be installed). The utility generally would acquire the components for the generating unit through competitive bidding (open to manufacturers or packagers of generating units), and competitively bid the engineering and construction contracts required to design and install the generating unit. Alternatively, the utility could also accept bids for generating units to be installed on a "turnkey" basis, in which case the utility would still own the generating unit and the site for the generating unit.

Subsequent to the adoption of PURPA, many jurisdictions on the mainland implemented competitive bidding systems under which independent power producers ("IPPs") could bid to sell power to utilities under a power purchase agreement (or "PPA"), or (with the exception of jurisdictions that excluded the utility ownership option) the utility could install and own new generation itself if the IPP alternatives were more costly. These bid processes could apply to a specific size and type of generating unit, or to a specific size of firm capacity increment (in which case bidders could submit bids for all or a part of the firm capacity increment). In some cases, the bid process would be used to determine not only who would end up building and owning new generation, but also would determine the specific types and sizes of new generation that would be added to the utility system.

An alternative competitive procurement process was implemented in Hawaii as a result of PURPA. Qualifying facilities are allowed to submit offers to sell firm capacity and energy to the utility at prices at or below avoided costs, pursuant to the rules established by the Federal Energy Regulatory Commission (“FERC”) under PURPA, and state rules (such as those in Title VI, Chapter 74 of the Hawaii Administrative Rules) implemented pursuant to the FERC rules. In Hawaii, the utility’s resource plan generally is that developed pursuant to its IRP process, taking into account any updates based on more recent planning assumptions and forecasts. For firm capacity resources, avoided costs are determined using the Differential Revenue Requirements (“DRR”) method, in which the utility’s revenue requirements for its base resource plan are compared to the utility’s revenue requirements (on a discounted present value basis) for a resource plan in which the IPP facility is allowed to defer or replace utility-owned new generation.¹

Utilities in Hawaii also have used a Request for Proposals (“RFP”) process to solicit proposals for new generation from IPPs. Under this process, the utilities can work with the developers of the best proposals to develop viable, feasible projects. This process may be followed when the more traditional request for bids (“RFB”) process is unlikely to elicit enough good proposals to allow the utility to simply select the best bid.

Competitive Bidding Objectives

The objectives of competitive bidding should be established to assess whether competitive bidding in general, or a specific competitive bidding process, will be beneficial.

¹ Avoided costs for as-available qualifying facilities have been based on the short-run avoided energy cost rates filed pursuant to HAR § 6-74-18, or on negotiated prices that have been determined to be at or below avoided costs using methodologies such as the DRR method.

To establish objectives, the purpose of a competitive bidding process should first be identified. Generally, a product buyer will implement a competitive bidding process in order to acquire a product that meets the buyer's needs (i.e., in terms of quality, quantity, and time and assurance of delivery) at the lowest cost. The key points are that the process is only implemented if it benefits the buyer using the process, and the products acquired using the process will meet the buyer's needs.

In order to meet the needs of a small, isolated island utility, the generation acquired under a competitive bidding process must meet the needs of the utility in terms of the reliability of the generating unit, the characteristics of generation needed by the utility, and the control that the utility needs to exercise over the operation of the generating unit in order to integrate the unit into its system.

Under state energy policy, the utility's focus is first on acquiring new renewable energy generation. That means that the competitive bidding process, if any, must facilitate the acquisition of renewable energy generation, and that other types of generation added to the system should accommodate the introduction of more renewable energy generation to the utility's system.

Hawaii utilities must have adequate assurances that new, firm capacity generation will be added when it is needed. Hawaii utilities do not have the option to acquire power from other jurisdictions, or even other islands, to backup the unfulfilled commitments of IPP developers of generation.

In order to ensure that the generation they acquire is at the lowest reasonable cost, utilities must be able to take into account all utility cost impacts that the addition of the new generation will have on the utility. If the addition of the new generation will require the addition

of new transmission resources, then that will impact the cost of adding the new generation to the utility's system, and may impact the amount of time required to add the new generation to the utility's system. If the utilities will have to restructure their balance sheets and increase their percentage of more costly equity financing in order to offset the impacts of purchasing power on their balance sheets, then this rebalancing cost must also be taken into account in evaluating the total cost of the new generating unit.

Should competitive bidding be implemented in Hawaii for new generation?

The HECO Companies have reservations about the applicability of competitive bidding to their small, isolated island systems. There are a number of concerns regarding the potential shortcomings of a competitive bidding process that should be addressed in the design, development and implementation of any competitive bidding program. The HECO Companies can support competitive bidding for certain forms of new generation, but only if it is structured in such a fashion that the potential benefits can be realized, and the potential disadvantages can be mitigated or eliminated, and that appropriate exceptions are recognized.

What competitive bidding process, if any, should be implemented?

Regulatory commissions have recognized that utilities have an obligation to serve and provide reliable service, and have an obligation to do so at lowest reasonable cost. Regulatory commissions also have recognized that acquisition of energy and capacity to meet the needs of customers remains the responsibility of the utility, and that these functions should not be delegated to an independent entity. Thus, the host utility should play a major role in the competitive bidding process, including: (1) designing the RFP documents, evaluation criteria, and power purchase agreement; (2) managing the RFP process, including communications with bidders; (3) evaluating the bids received; (4) selecting the bids based on the established criteria;

(5) negotiating contracts with selected bidders; and (6) competing in the solicitation process with a self-build option, if feasible.

All of these roles for the host utility are common in most RFP processes and are recognized by regulators and third-party bidders as reasonable roles for the host utility. Recent competitive bidding dockets have recognized the role of the utility and have supported an active role for the host utility. In fact, in several recent RFP processes, utility self-build or turnkey options have been the successful bidders among a large number of options.

The goal of any competitive bidding process is to encourage and evaluate a range of generation options with the objective of obtaining the best option for the customers of the utility. This goal can only be assured if all resource options are allowed to compete. Regulatory commissions have recognized that a utility project may be the lowest cost option and failure to allow that option to compete may result in higher cost power options, contrary to their goals and objectives.

With regard to host utility self-build options, utilities have been selecting their own build options more frequently over the past few years for several reasons. First, the financial and credit problems faced by independent generators have led to higher debt costs and higher equity ratios for independent generators, virtually eliminating the competitive advantage once enjoyed by independent generators. Utility projects are now competitive from a financial perspective. Second, transmission constraints in a number of markets have led to higher transmission costs for resources located outside the utility service area or in costly transmission areas. Third, the deteriorating credit quality of many independent generators has raised concern over counter-party reliability. In turn, power purchase agreements require higher levels of security and tighter damage provisions to protect the utility's customers against the prospect of contract

default. There is heightened concern that independent generators are less reliable than host utilities in developing and operating their projects.

For a competitive bidding process to result in selection of the lowest cost resources consistent with the utility's needs, all relevant costs should be recognized for each bid, in addition to the direct cost of the bid option itself. This includes the transmission costs and system impacts associated with each project, system operational impacts, and the impacts of purchased power on the utility's balance sheet.

In conjunction with the inclusion of credit quality and financial impacts in the evaluation of power purchase agreements, the inclusion of turnkey projects provides the correct signals for the bidder to structure its project recognizing the value of the project structure. For example, if bidders are concerned that a straight power purchase agreement will not be competitive if financial impacts are accounted for during the evaluation, the bidder will also have the option to offer a turnkey arrangement as well.

The competitive bidding process should recognize the value of flexibility in the evaluation of resource alternatives. Such flexibility options as contract buy-out options, project in-service date deferral or acceleration provisions, or project acquisition options are valuable options for a utility to more effectively balance its needs with the cost of obtaining such options. Given the nature of their Island systems, the HECO Companies are also concerned about fuel flexibility and the option to convert to an alternative fuel if fuel cost or availability changes dramatically.

Competitive bidding will not be beneficial in Hawaii unless electric utilities are able to (1) participate as bidders in the process, and (2) conduct the competitive bidding process (which includes sending out the RFP, pre-qualifying bidders, evaluating the bids, and selecting the

winning bid or bids). Given the dual role of the utility in the process, the HECO Companies recognize that some form of Independent Observer would be required to monitor the process, and report to the Commission at various steps of the process. The Commission would then approve the result of the process by approving the commitment of expenditures for utility-owned generation and/or the power purchase agreement (“PPA”) for generation owned by independent power producers (“IPP”).

Which resources should be subject to the competitive bidding process?

The RFP process should allow a variety of supply-side options to compete. With regard to DSM and CHP, however, it is important to recognize that these resources are very different from traditional supply-side resources and should not become subject to the same bid process. The bid process for new generation should not apply to DSM, and a separate competitive procurement process should be applied in the case of utility-owned CHP systems.

In determining (1) whether to implement competitive bidding, (2) what form of competitive bidding, if any, to implement, and (3) when to apply the new process, the Commission will have to consider the resources and time required to implement competitive bidding on the part of the utility, the Commission, and the Consumer Advocate. The time required to implement competitive bidding will have to include the time required to establish the competitive bidding process, and the time required to conduct the process.

It would be imprudent to apply a new competitive bidding process to new generation that must be added sooner than generation could be added using the process that has yet to be developed.

How should competitive bidding procedures be developed?

The details of the competitive bidding process should be developed in a follow up proceeding, based on the principles enunciated by the Commission in this proceeding. The HECO Companies prefer that the procedures be developed and adopted in a framework proceeding, like that used to develop the IRP Framework, rather than in a rulemaking proceeding.

It took 28 months (from January 10, 1990 to May 22, 1992) to complete the proceeding in which the IRP Framework was adopted. However, that included the time required to develop collaborative principles. Rulemaking proceedings also have taken a number of years to complete.

The development and implementation of a competitive bidding process can be a very time consuming process, generally taking several years to complete. However, taking the time necessary to effectively develop the process in the early stages serves to avoid the potential for very costly mistakes and potential delays later in the process.

How should competitive bidding be integrated with IRP?

The IRP Plan can continue to be developed using the current process followed by the HECO Companies. In this case, the role of the IRP Plan should be to identify the preliminary “preferred” resource plan, define capacity and energy requirements, the timing of need, any preferred technologies, and potentially any other preferred attributes. The IRP Plan can also be used to identify any preferences or criteria for resource selection and can be used to determine avoided costs.

In this model, the role of the RFP would include the solicitation and evaluation of resource options to meet the capacity and energy needs identified in the preliminary preferred

resource plan. The RFP can be used to solicit bids for either a block of resources as defined in the IRP Plan or for the next required resource identified in the IRP Plan. Bidders would be allowed to submit proposals for any variety of resource types and sizes. The utility also would have the right to submit proposals for resources that may differ from the preferred resource type included in the preliminary resource plan. The bids received in response to the RFP would be evaluated relative to one another and/or to the avoided costs of the generic resource identified in the IRP Plan or to the utility self-build project. The IRP Plan would establish the parameters for the RFP. After the bids are evaluated and the preferred resource selected, the utility would then build the resource (if a self-build system is selected), or negotiate a turnkey contract or power purchase agreement (“PPA”) with the winning bidder (if a turnkey or PPA option is selected). The utility would essentially complete its preferred resource plan after the bids are received -- the final bid(s) selected would be part of the final IRP Plan.

II. ISSUES

The positions of the HECO Companies on the issues listed in Prehearing Order No. 20923 (April 23, 2004) are addressed in Exhibit A to this Statement of Position.

III. EXHIBITS

The Exhibits to the Statement of Position include:

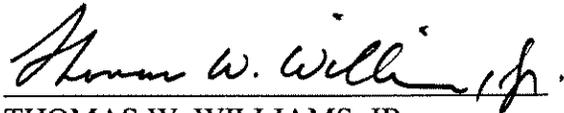
- Exhibit A - Positions of the HECO Companies on the Issues Listed in Prehearing Order No. 20923
- Exhibit B - Evolution of Competitive Bidding for New Generating Capacity
- Exhibit C - Competitive Bidding for New Generating Capacity-Accounting Issues²

² This exhibit is identical to Exhibit C to the Application in Docket No. 04-0320, filed November 5, 2004, requesting approval of Amendment Nos. 5 and 6 to the Power Purchase Agreement between HECO and Kalaeloa Partners, L.P.

Exhibit D - Workshop on Competitive Bidding, Docket No. 03-0372, Presentation of
Wayne Oliver, September 28, 2004

Exhibit E - Competitive Bidding Status by State

DATED: Honolulu, Hawaii, March 14, 2005.



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CERTIFICATE OF SERVICE

I hereby certify that I have this date served a copy of the foregoing Statement of Position and Exhibits A-E, together with this Certificate of Service, by hand delivery and/or by mailing a copy by United States mail, postage prepaid, and properly addressed to each such party:

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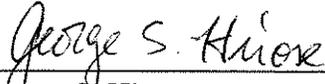
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