Inside Hawaii activists' push to ditch HECO and transform the utility business model

Doubts about the NextEra merger are fueling calls for a co-op or muni for each island

By Herman K. Trabish | May 28, 2015

In Hawaii, a group of citizens is rising up against the proposed merger of the Hawaii Electric Industries (HEI) and NextEra Energy, and demanding a voice in decisions about their energy future.

If their rebellion succeeds, Hawaiians will find out if their complaints about HECO are due to the nature of rooftop solar and its integration onto the grid, or if the solar market in Hawaii is being held back by the utility's intransigence.

"Hawaii is at a crossroads. We have disruptive technologies that are changing how customers expect to get energy," explained Spokesperson Rob Harris on behalf of KULOLO (Keep Utilities Locally Owned, Locally Operated), a group pushing for alternative utility models in Hawaii, and TASC (The Alliance for Solar Choice), a founding member of KULOLO.

In response to their concerns about the merger, local leaders have initiated information-gathering processes to better understand how they might form an electric cooperative (co-op) or municipal utility (muni) to replace the HEI subsidiaries known collectively as HECO.

"We believe the Utility 2.0 model might be a publicly owned one," Harris said.

NextEra Energy has been asked by Hawaii's legislators, regulators, and energy industry stakeholders to detail its plans for Hawaii's energy future, explained Attorney Isaac Moriwake, on behalf of the Sierra Club, another founding member of KOLULU.

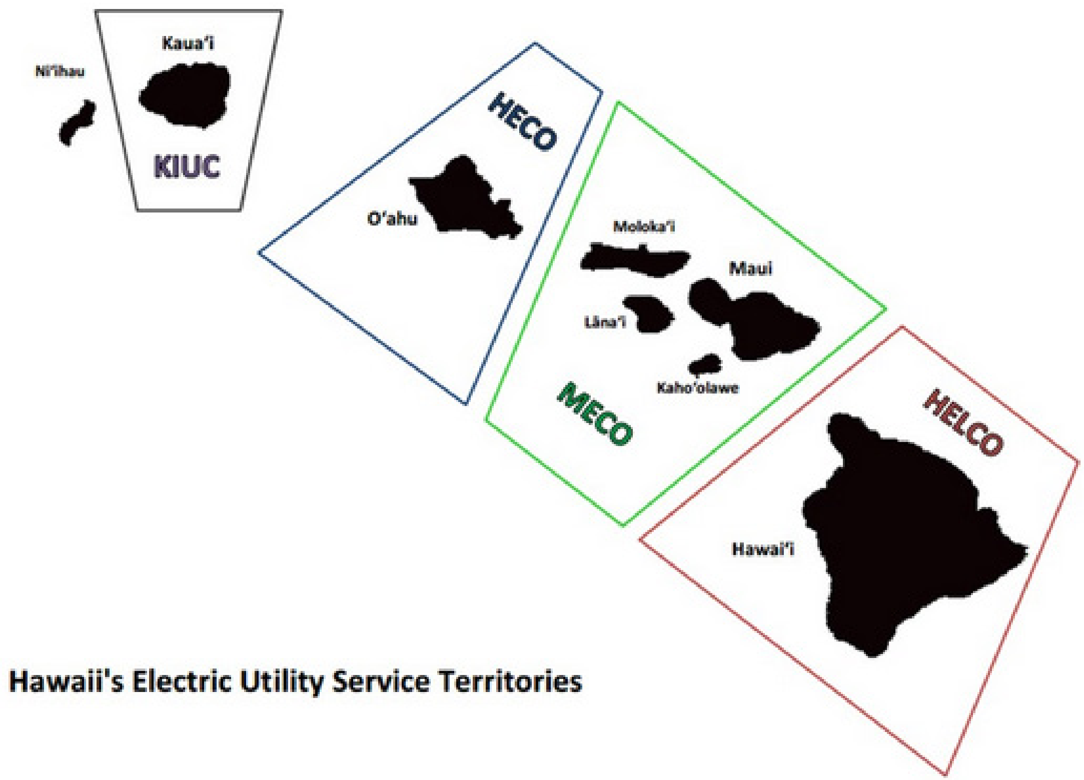
"So far, they have insisted they are not going to provide any specific plans until the merger is approved," he said. "That is exactly backwards. How can the PUC ensure that NextEra is the right fit for Hawaii without such disclosure?"

Recent polls show most of the state's population has not yet focused on the question, but a slight majority is opposed to the merger, and that gives activists hope that they have a special opportunity to fundamentally transform the utility business model on the islands.

The public option

In an effort to gather information on how to replace Hawaiian Electric Co. (HECO), Oahu's Honolulu City Council is preparing to fund a study on options. To replace Maui Electric Co. (MECO), Maui County Mayor Alan Arakawa issued a Request for Proposals for a similar study.

To replace Hawaii Electric Light Co. (HELCO) on the big island, an aggressive group has formed the Hawaii Island Electric Cooperative (HIEC). That group is basing its efforts on the model of Kauai's successful Kauai Island Utility Cooperative (KIUC) which has already relieved HEI of 5% of the state's load.



Credit: State of Hawaii fiscal year annual report

“The public option is very real and we want to make sure it is on the table,” Harris said.

Some 700 people signed a KULOLO petition urging the state’s decision-makers to consider it, he added. “That might be a statewide solution or simply providing funding to the counties or a financial package for a single consultant” to study the issue, Harris said.

The Hawaii Public Utilities Commission is under-resourced and overworked, Moriwake said, but they have made their priorities clear, and NextEra and HECO have failed to detail how they will meet them.

“That is why people on all the islands are rebelling,” he said. “How else can people react when a big mainland company comes in to swallow up the local utility and won’t say specifically where we’re headed?”

The rebellion’s fate may turn on the Hawaii commission’s decision on the $4.3 billion NextEra-HEI merger. The companies have worked to limit the stakeholders intervening in the proceedings, critics say, because intervenors will have access to discovery.

“The question is whether the acquisition price is fair, just, and reasonable, so discovery will legitimately include an inventory of HECO facilities,” explained consulting economist and regulatory proceedings expert Jim Lazar, who works with the Regulatory Assistance Project.

Having that inventory would make a more accurate estimate of costs and savings by a co-op or muni possible, he said.

After the commission approved 29 intervenors, including KULOLO members, activists say that a HECO legal consultant emailed petition signers, essentially warning them KULOLO participation made them "competitors with HECO and NextEra," and disqualified them from intervening.

The emails were widely seen by activists and other intervenors as an intimidation tactic.

"The proposition is laughable," Harris said. "Our members are simply calling for consideration of a public option."

Because NextEra Energy is "focused on the transaction," wrote Communications Director Steve Stengel, it chose to "respectfully decline" an invitation to discuss these and other merger-related issues.

"Our focus is on the pending merger," said Hawaiian Electric Spokesperson Peter Rosegg, because NextEra Energy is the "ideal partner" to accelerate Hawaii toward its goals of cutting customer bills 20%, tripling distributed generation, and to 100% renewables by 2045.

HECO's alleged failures

"HECO moves a lot slower than other companies, and that is a problem because their business is moving faster," Lazar said.

Hawaiians argue HECO has slowed rooftop solar interconnections. Its excuse is the sheer volume of applications. An estimated 25% of the state's single family homes, clustered in subdivisions, have rooftop solar.

"About half of HECO circuits are back-feeding to the system rather than drawing from it at noon," Lazar explained. "No other utility in the country is experiencing anything like that."

"Investor owned utilities by design are inherently conservative and slow to change but now they need to be entrepreneurial, flexible, and innovative," Harris said. "It is not in their make-up."

"The IOU model has been successfully used throughout the nation in areas of significant size to attract equity and debt at reasonable rates to pay for needed investments to achieve an increasingly modernized grid," Rosegg insisted. "It is a proven organizational structure."

The PUC could require the new HECO-NextEra company "to provide customer choice and energy efficiency options and make investments in the grid to ensure that happens," Harris said, but critics say HECO has a history of failing to meet such commission dictates.

Despite Hawaiians' vociferous demands for more renewables, HECO's 2013 integrated resource plan (IRP) was so inadequate the commission demanded it be redone, in "the strongest worded regulatory language I have ever seen in my career," Lazar said.

The 2014 IRP was accepted by the commission but has not been acted on. It was widely criticized in public filings and so flawed that regulators saw no point in asking for another version, Harris and Lazar said.

"If you are 5'4" and you can't jump and you can't shoot, it is unlikely, no matter how much I yell at you, that you will get to the NBA," Harris said, comparing the utility to the hopeless basketball player.

Will NextEra change things?

NextEra has given no indication it will improve on HECO's record, Moriwake said. "The most they have said so far is that they support and will accelerate the plans outlined in HECO's last IRP."

NextEra's unregulated subsidiaries build central station wind and solar, Lazar said. "Solar advocates are concerned it will move toward the state's renewables goals with central station renewables, and destroy the distributed solar business."

Its regulated arm, Florida Power & Light, "has done a bad job on conservation, a bad job on distributed generation, and they are clearly not the utility people in Hawaii are looking for," Lazar added.

IOUs have resisted rooftop solar and energy efficiency because their goal is shareholder returns and shareholder interests and consumer interests are diverging, Harris said. "In FPL's vertically integrated model, they generate all the power and sell all the power. One would have to presume that is the model they want to bring to Hawaii. That is why we think the public option should be on the table."

The NextEra-HECO merger could provide a scale that would streamline the addition of renewables, acknowledged GenX Energy Managing Developer and Maui co-op advocate Leo Caires. "But the concerns I hear are about whether the IOU structure is the most efficient over the long term."

An IOU would be obligated to deliver profit to its shareholders, he said. "In one, you are paying for something that has a margin. In the other, it is priced at cost. NextEra needs to be profitable. That affects their decisions."

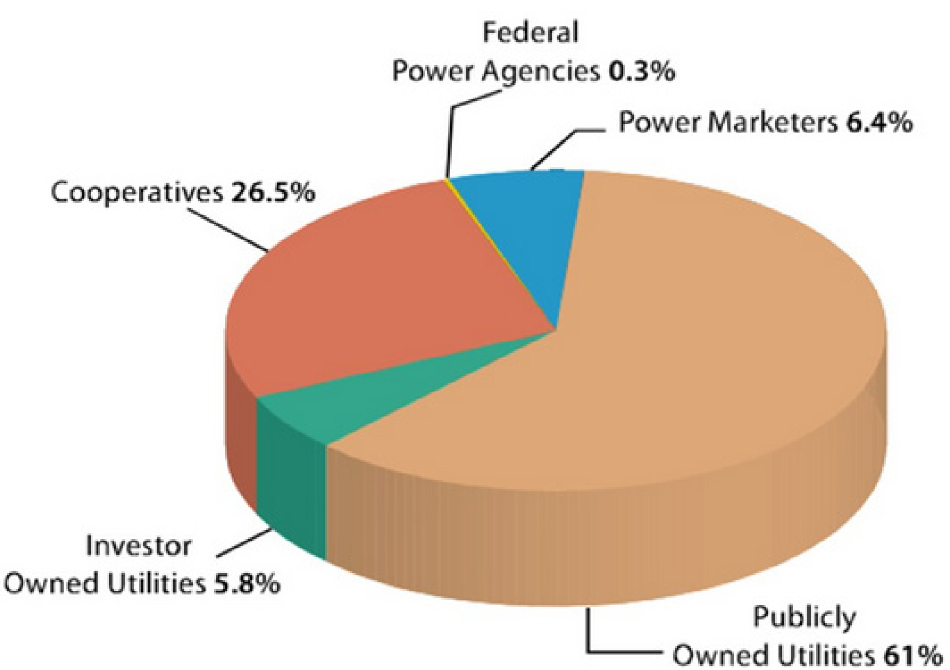
"Our employees share a strong commitment and sense of responsibility to serve the communities where we and our families all live and work, Rosegg said. "That's why we are working so hard toward our community's goals."

A co-op or a muni?

"If the PUC turns down NextEra, HECO had already said 'we are for sale' so it will open the door for alternatives," Lazar said. "Other companies might want to acquire HECO but they aren't likely to be what Hawaiians want. The mood is for individual island control. The sentiment is for co-ops but the pragmatism is for municipals."

Laws vary state by state and some favor a co-op model or a municipal utility, Lazar explained. One crucial distinction would be whether either public option would be limited by its right to use eminent domain to acquire HECO infrastructure.

"Hawaii law does not make any distinctions between types of utilities in terms of their powers of eminent domain," Attorney Moriwake said. "There wouldn't be any limit or handicap on such powers for a muni or co-op."



61% of utilities may be publicly owned, but they account for 14% of customers, according to APPA, while the IOUs cover more than 60% of power customers.

Credit: From the American Public Power Association

Both Harris and Moriwake said the emerging public option discussion has not yet distilled into a debate on relative advantages and disadvantages. Both are so far agnostic.

Co-ops and Kauai

KIUC is everyone's example of a successful co-op. "It does solve some problems with the IOU model like the inherent conflict between ratepayers and shareholders that is a stumbling block for the HECO companies," Moriwake said. "As long as we're clear on the pros and cons and how to manage them, that may be an acceptable alternative for 21st century Hawaii utility regulation."

KIUC has, for over ten years, been an electric utility that is democratically owned and operated and not obligated to shareholders. It also sends its customers a check when its finaincial objectives are met, rather than kicking profits up to investors, explained ProVision Solar President Marco Mangelsdorf, who is also the director of the Hawaii Island Energy Cooperative (HIEC), a nonprofit founded to explore options for alternative utility business models for Hawaii.

Mangelsdorf is leading preparations on the Big Island to acquire HELCO if regulators deny the NextEra deal. And, he recently noted, regulators could also attach a list of stipulations to the merger that the boards of Hawaiian Electric and NextEra would find unacceptable. That regulatory strategy is one commonly taken in utility merger dockets, including in the ongoing proceedings on the proposed Exelon-Pepco and Wisconsin Energies-Integrys mergers, although in both those cases the utility boards have agreed to the stipulations.

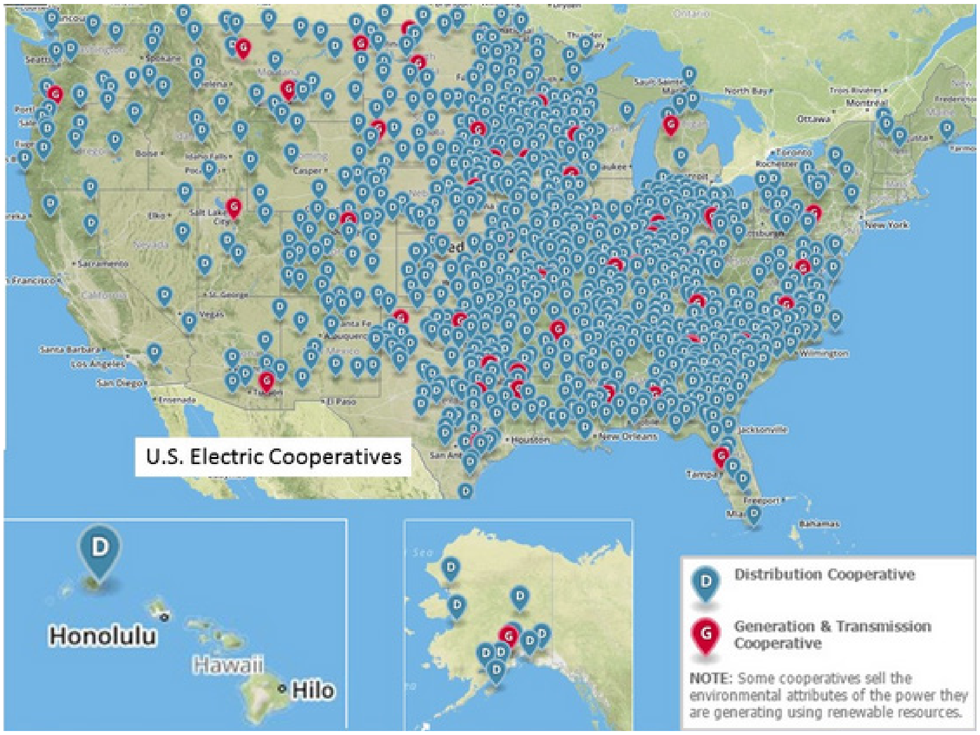
Benefits expected from the a potential HIEC cooperative could include, Mangelsdorf said, local control of infrastructure, strategies focused on local needs, lower electric costs obtained from the use of local resources and technologies, increased energy independence, and more renewables.

"The biggest disadvantage of a muni as opposed to a co-op is capital allocation," Caires said. "Under a cooperative structure, the capital is for it specifically. Under a municipality, other services and needs within the county would compete for the capital in the General Fund and the governing body would decide how much would go to water, to roads, or to the city side."

A cooperative also has a cost of capital advantage, he added. Federal agencies provide co-ops low interest loans for asset investments.

"Kauai has led the charge," Caires said. "It has outperformed the projections at the time of the changeover. That is a case study Hawaii has to look at."

But forming a co-op structure "does not guarantee the organization will have access to government funding or loans," Rosegg cautioned.



Co-ops are relatively small compared to IOUs. While they account for less than 13% of customers, there are more than 800 of them nationwide.

Credit: National Rural Electric Cooperative Association

The municipal option

KIUC's success has impressed Hawaiians but it was created with the advantages of a friendly takeover and a small, uniquely accountable community, Lazar said. "11% of the American public is served by cooperatives and they do a fine job of keeping the poles vertical and the wires horizontal," he explained.

As to capital allocation, "in most cases, munis are set up as enterprises and the money goes into an enterprise fund, not a general fund." But a muni has two important cost advantages: (1) access to tax-exempt financing through the issuance of tax exempt bonds and (2) being a part of municipal operations.

It is not clear that either cooperative or municipal ownership can be finally established or whether either "would have access to government subsidies or loans," Rosegg insisted.

The City of Palo Alto Utilities puts all its services on one bill with one phone number and is operated by one cross-trained staff. "When a power line goes down, the gas crews are directing traffic while the line crews do the repair," Lazar said.

Munis are among the best public options, agreed Harris. The Sacramento Municipal Utility District, for instance, has very high customer satisfaction ratings and low electricity rates compared to PG&E, which surrounds its territory.

And because billing is a huge cost for utilities, consolidated handling of the sewer, water, and electrical bills through a single billing center could produce savings a co-op could not obtain.

But either public option allows a new kind of creativity, Harris said.

"A public entity can be told to have lower rates, ensure reliability, ensure customer choice, and achieve the state's energy goals," he said, "and it could be compensated on its ability to achieve those things."