Dear Commissioners:

Subject: Transmittal No. 13-01 (Decoupling)
Maui Electric Company, Limited – Parties’ Letter Agreement

This letter documents certain agreements between Maui Electric Company, Limited (“MECO” or “Company”), and the Division of Consumer Advocacy of the Department of Commerce and Consumer Affairs (“Consumer Advocate”) (collectively referred to as the “Parties”) regarding matters in this proceeding. The agreements set forth in this letter are the result of discussions between the Parties following the filing of the Consumer Advocate’s Statement of Position (“Consumer Advocate’s SOP”) on May 6, 2013.

The agreements set forth in this letter are reflected in the Company’s Revised 2013 Decoupling Calculation Workbook which is an attachment to the Company’s Response to the Consumer Advocate’s SOP (“Response”) filed on May 14, 2013. (The Company’s Revised 2013 Decoupling Calculation Workbook also reflects corrections for errors identified in the Consumer Advocate’s SOP. The Company agreed to these changes in its Response.) The agreements in this letter address substantive differences between the Parties and go beyond making these corrections for errors to the decoupling tariff submission. As a result, these agreements are included in this separate letter.

The agreements set forth in this letter are for the purpose of simplifying and expediting this proceeding, and represent a negotiated compromise of the matters agreed upon, and do not constitute an admission by any party with respect to any of the matters agreed upon herein. The Parties expressly reserve their right to take different positions regarding the matters agreed to herein in other proceedings.
The agreements are as follows:

1. Tax Loss Carryforward Balances in Rate Base

   The Company agrees with the Consumer Advocate’s position excluding an amount equivalent to the $5,772,000 deferred tax asset ("DTA") from the recorded accumulated deferred income tax ("ADIT") balance as of December 31, 2012 for purposes of calculating MECO’s 2013 Rate Base RAM. This DTA at issue relates to the federal tax benefits of a net operating loss ("NOL") realized for financial statement purposes but not yet realized in cash if income tax carryforwards are analyzed on a stand-alone basis.

   In Schedule D4 of its Transmittal No. 13-01 (Decoupling) filed on March 28, 2013, MECO presented its ADIT balance as of December 31, 2012 of $50,148,000, which included the recorded DTA balance of $5,772,000.

   In its Statement of Position ("SOP") filed on May 6, 2013, the Consumer Advocate took the position that this recorded DTA should not be included in the RAM Rate Base for several reasons. First, this DTA item related to an NOL has not been included in MECO’s rate base in prior cases and such a complex ratemaking issue should not be approved in an expedited decoupling tariff transmittal unless there is an opportunity for discovery, analysis and testimony that could occur in a rate case. Second, MECO should adjust its NOL for tax deductions that are not allowed for ratemaking purposes. Third, the Company has acknowledged that, as of 12/31/12, HEI consolidated did not have an NOL carryforward for which a DTA would have been provided and that, HEI consolidated, excluding MECO, anticipates generating taxable income sufficient to absorb 2013 federal tax losses generated by MECO. Finally, the Consumer Advocate asserted that consideration should be given to the absence of any NOL for the HECO utilities on a combined basis when HELCO’s large positive taxable income in relevant carryback tax years is more than adequate to allow full realization of all tax deductions and any resulting estimated negative taxable incomes that may be experienced at MECO or HECO on a standalone basis.

   With regards to the Consumer Advocate’s first point of contention, MECO recognizes the novelty and complexity of this DTA issue and acknowledges that this issue would be more appropriately resolved in a general rate case, where all factors can be adequately considered. Consequently, the Company agrees with the Consumer Advocate’s position excluding an amount equivalent to the $5,772,000 DTA from the recorded ADIT as of December 31, 2012.

   Regarding the Consumer Advocate’s second point, although not relevant due to MECO’s agreement in this letter, the Company agrees with the Consumer Advocate that the NOL on which the DTA is based should be adjusted for tax deductions that are not allowed for
ratemaking purposes. The Company identified these deductions and determined that the impact on DTA was to decrease the DTA by $925,000. As to the remaining $4,847,000 of tax benefits associated with expenses allowed for ratemaking purposes and included in the NOL, MECO asserts that this DTA is includable in rate base, but makes the above agreement to exclude the DTA in the interest of resolving this issue.

With regards to the Consumer Advocate’s last two points, as stated in MECO’s Response to the Consumer Advocate’s SOP ("Response") (pages 5-9), MECO does not agree that consideration should be given to the fact that as a consolidated group (the HEI group or the Hawaiian Electric subgroup, including Hawaiian Electric Company, Inc., Hawaii Electric Light Company, Inc., and MECO), the tax benefits related to the NOL have been realized and therefore MECO should not be allowed to earn on the DTA related to the NOL. MECO’s DTA should be included in rate base since on a standalone basis, the DTA relates to NOL tax benefits not yet realized by MECO.

However, as stated above, considering all of the factors discussed and in the interest of resolving all issues in this proceeding, MECO agrees with the Consumer Advocate’s position to exclude an amount equivalent to the $5,772,000 DTA from the recorded ADIT balance as of December 31, 2012.

2. Deferred Regulatory Asset Balances in Rate Base

In Attachment 2, Schedule D1 of its Transmittal No. 13-01 (Decoupling) filed on March 28, 2013, MECO presented its calculation of the average 2013 rate base of $412,881,000. Based on this calculated rate base amount, the Company derived its 2013 Rate Base RAM – Return on Investment of $2,472,665, as shown in Schedule A of Transmittal No. 13-01. The deferred regulatory asset balance for the Customer Information System ("CIS") project included in the 2013 calculated rate base was based on the Hawaiian Electric Companies' and the Consumer Advocate’s Stipulated Settlement Agreement regarding Certain Regulatory Matters ("Stipulated Settlement"); filed in Docket No. 2008-0083, and approved by the Commission in Order No. 31126, issued on March 19, 2013. Based on its understanding of the Stipulated Settlement (including Exhibit 3 of the referenced document), MECO included estimated carrying charges for the period from January 1, 2013 through May 31, 2013 in both the beginning (December 31, 2012) and ending (December 31, 2013) balances for the CIS project regulatory asset. The estimated 2013 accrued carrying charges for the CIS project amounted to $89,000.

In its SOP, the Consumer Advocate recommended that the beginning balance of the deferred regulatory asset would be “more properly stated at December 31, 2012 in the amount $2,708,000 as documented at MECO-WP-D1-002 CIS.” (Consumer Advocate’s SOP at 14). The Consumer Advocate’s understanding of the Stipulated Settlement was
that it did not provide for a variance from the December 31 valuation dates with respect to the Rate Base RAM valuations. (Consumer Advocate’s SOP at 14-15).

As stated in MECO’s Response (pages 10-11), the Company disagrees with the Consumer Advocate’s position. *Order No. 31126, Approving, with Clarifications, Stipulated Settlement Agreement, Filed on January 28, 2013*, in Docket No. 2008-0083 approved the Stipulated Settlement which calls for the Hawaiian Electric Companies to include the net recoverable cost of the CIS project not already included in rates, as reflected in Exhibit 3 of the [Stipulated Settlement] in their 2013 RAM Revenue Adjustments (Stipulated Settlement at 2). The Company points out that on the referenced Exhibit 3, page 2, the CIS amounts shown under the “Rate Base RAM 12/31/2012” column include the carrying charges estimated for January 1 through May 31, 2013. The amount reflected in Attachment 2, Schedule D1 for the beginning (12/31/12) balance is consistent with the referenced Exhibit 3 of the Stipulated Settlement. See MECO-WP-D1-002.

In order to resolve the remaining issues in this proceeding, MECO agrees (1) to use the regulatory asset value with respect to the CIS regulatory asset balance at December 31, 2012 as proposed by the Consumer Advocate, and (2) to forgo an adjustment to ADIT associated with the carrying charges incurred in 2013 and included in the Company’s ADIT balance at December 31, 2012.1

3. Rate Base Working Cash Allowance - Earnings Sharing Revenue Credits

In Attachment 2, Schedule H; of its transmittal, the Company calculated its 2012 “Earnings Sharing Revenue Credits” based on a 2012 rate base value of $402,974,000. This amount included average working cash of $11,350,000. The Company calculated working cash for “rate making” earnings sharing purposes by multiplying the 12-month actual working cash expense components by their respective ratios. The respective ratios are calculated as the net collection lag days approved in the most recent test year rate case, divided by 365 days.

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1 The Company’s agreement with the Consumer Advocate’s position creates an inconsistency between the December 31, 2012 deferred regulatory asset balance and the ADIT balance. In adjusting the December 31, 2012 deferred regulatory asset balance (excluding the 2013 carrying charges to be incurred), the Consumer Advocate did not adjust ADIT for the lower carrying charges, which is a book/tax difference. The adjustment would have resulted in a decrease of $9,592 in the December 31, 2012 ADIT balance and a corresponding increase in the 2013 projected ADIT change. However, MECO has agreed to no change in the ADIT for deferred regulatory assets as a concession towards resolution of this issue.
The Consumer Advocate's position is that working cash should not be included in rate base for purposes of calculating Earnings Sharing Credits at a value different from the fixed amount included in the Rate Base RAM which is determined by the Commission in the Company's most recent test year rate case. Because working cash is a calculated value that is not represented by actual balances recorded in the Company's general ledger, the Consumer Advocate states that working cash is a complex ratemaking issue that requires extensive calculations in the form of a lead lag study, which should be undertaken and reviewed in the context of a rate case proceeding. The working cash (or cash working capital) amount determined in the last rate case "should not be replaced or superseded by calculations in a decoupling tariff transmittal whose review is conducted on an expedited basis with no opportunity for the needed discovery, analysis and testimony that would occur in a rate case." Further, because working cash is a calculated or derived value, the Consumer Advocate believes that by fixing the amount at the same level used for the calculation of the Rate Base RAM, "the determination of earnings sharing credits, if any, should not be influenced either positively or negatively by side calculations that produce a higher or lower Working Cash allowance." (Consumer Advocate's SOP at 16-17). As a result, the Consumer Advocate recommended a reduction to the average rate base used in Schedule H by $693,000 to fix working cash at the amount last approved by the Commission in Docket No. 2011-0092, consistent with Schedule D1 (Consumer Advocate's SOP at 17).

As stated in MECO's Response (pages 12-13), the Company disagrees with the Consumer Advocate's adjustment. The Company maintains that (1) its calculation on Schedule H is consistent with the amount included in the quarterly filing of ratemaking rate of return on rate base and return on common equity submitted to the Commission for the twelve-month period ended December 31, 2012 and (2) the Company's use of actual average amounts in its calculation of working cash in the 2012 Earnings Sharing Credit calculation is based on the MECO RAM tariff, Sheet Nos. 96D (Maui Division), 107D (Lanai Division) and 151D (Molokai Division), which states the following with respect to the Evaluation Period Earnings Sharing:

The schedules will include the following:

a) Company's recorded actual average net plant in service, accumulated deferred income taxes, inventory, working capital, and other rate base components. The schedules shall also show the utility's depreciation expense, operating and maintenance expense, income taxes, taxes other than income taxes, and other components of income for return, revenues, and capital structure, cost of debt, overall cost of capital, and return on common equity in the format set forth in the final order establishing the Company's latest effective rates...
For the sole purpose of resolving the remaining issues in this proceeding, the Consumer Advocate agrees to withdraw its proposed adjustment to working cash used in rate base in the Earnings Sharing Credits calculation.

Sincerely,

Patsy H. Nanbu
Vice President
Maui Electric Company, Limited

Concurred:

Jeffrey T. Ono
Executive Director
Division of Consumer Advocacy
Department of Commerce and Consumer Affairs

cc: Division of Consumer Advocacy