

Decision _____

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of Great Oaks Water Company
(U162W) for an Order authorizing it to issue
long-term debt in the amount of \$4,000,000.

Application 14-01-023
(Filed January 30, 2014)

**DECISION ADOPTING ALL-PARTY SETTLEMENT AND
AUTHORIZING GREAT OAKS WATER COMPANY
TO ISSUE UP TO \$4 MILLION OF NEW DEBT SECURITIES**

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**DECISION ADOPTING ALL-PARTY SETTLEMENT AND
AUTHORIZING GREAT OAKS WATER COMPANY
TO ISSUE UP TO \$4 MILLION OF NEW DEBT SECURITIES**

Summary

This decision adopts the all-party settlement reached by Great Oaks Water Company (Great Oaks) and the Office of Ratepayer Advocates, authorizes Great Oaks to issue new long-term debt not exceeding \$4 million pursuant to Public Utilities Code §§ 816 – 830, and grants Great Oaks an exemption from the New Financing Rule.

1. Background

Great Oaks Water Company (Great Oaks) is a Class A water utility under the jurisdiction of this Commission that provides water service to approximately 20,500 customers in its San Jose and Santa Clara County service areas.

On January 28, 2014, Great Oaks filed Application (A.) 14-01-023 requesting authorization to issue new long-term debt (debt) not exceeding the aggregate amount of \$4 million, and other related requests. On March 3, 2014, the Office of Ratepayer Advocates (ORA) filed a protest, to which Great Oaks filed a response on March 6, 2014. On April 21, 2014, a prehearing conference (PHC) was held to determine the scope and schedule of this proceeding. On April 30, 2014, Commissioner Michael Picker issued his Assigned Commissioner’s Scoping Memo and Ruling (Scoping Memo).

Based on an email request from Great Oaks and ORA (the Parties) that evidentiary hearings be removed from the calendar, the assigned Administrative Law Judge (ALJ) removed the evidentiary hearings scheduled for June 27, 2014 from the calendar.

On July 23, 2014, the Parties jointly filed a motion requesting receipt of testimony into the record and, on July 29, 2014, the Parties jointly filed a motion

requesting adoption of an all-party settlement agreement. Both of these motions are discussed in detail below.

2. Applicable Public Utilities Code Sections

Great Oaks' request is subject to Public Utilities (Pub. Util.) Code §§ 816-830. The Commission has broad discretion under §§ 816 *et seq.* to determine if a utility should be authorized to issue debt. Where necessary and appropriate, the Commission may attach conditions to the issuance of debt and stock to protect and promote the public interest.

Pursuant to § 817, a public utility may only issue and use financing for selected purposes. Those purposes not listed in § 817 may only be paid with funds from normal utility operations. As discussed below, Great Oaks has substantiated that the issuance of new long-term debt is necessary for the reimbursement of Great Oaks for money expended from its treasury funds for capital additions, as well as for future capital additions. These purposes are authorized by § 817 and, as required by § 818, are not reasonably chargeable to operating expenses or income.

Pursuant to § 824, the Commission may require Great Oaks to maintain records to identify the specific long-term debt issued pursuant to this decision, and demonstrate that proceeds from such debt have been used only for public utility purposes.

3. Request

Great Oaks proposes to issue up to \$4 million of new debt, and use such new debt for proper purposes, pursuant to Pub. Util. Code § 817. Great Oaks also seeks an exemption from the New Financing Rule.

3.1. Requested New Debt

Great Oaks anticipates that its new debt would be privately placed as a long-term promissory note (note) at a rate of 7.5 percent and term of approximately 14 years, with John Roeder, the Chairman and Chief Executive Officer (CEO) of Great Oaks.

Prior to filing the current application, Great Oaks entered into a short-term obligation of \$4 million with Roeder. Under its terms, this short-term obligation may be extended to December 31, 2028, and converted into long-term debt.¹

3.2. Use of Proceeds from New Debt

Great Oaks would use the proceeds from the sale of the new debt for purposes permitted by Pub. Util. Code § 817 (*see* Table 1 below), including to reimburse moneys already expended from Great Oaks treasury for the previously authorized construction, completion, extension, or improvement of its facilities from 2006 through 2013. Great Oaks plans to use the remainder of the \$4 million to pay for plant additions authorized in Decision (D.) 13-05-020, scheduled for the 2013-2014 fiscal year. Great Oaks has no outstanding financing authority to offset its current need for funds.

Intangible Plant	\$46,095.20
Source of Supply Plant	\$ 519,233.65
Pumping Plant	\$ 67,756.49
Transmission and Distribution Plant	\$1,703,383.51
General Plant	\$1,374,378.54
Total Treasury Reimbursement	\$3,710,847.39
Total Request	\$4,000,000.00
Remainder - 2013-2014 Fiscal Year Plant Additions	\$ 289,152.61

¹ See A.14-01-023 at Exhibit A, paragraph 17.

This request is similar to one made by Park Water Company (Park)² in A.12-10-016 and authorized in D.13-02-007. Instead of estimating how much it will need in the future for proper purposes pursuant to Pub. Util. Code § 817, it expends the funds first, then requests financing when its cash reserves are depleted.

In past general rate case decisions for Great Oaks,³ the Commission has imputed a capital structure, because Great Oaks actual capital structure consisted of 100 percent equity. The Commission consistently found that “Excess levels of common equity burden the ratepayer with excessive rates.”⁴ In our decision regarding Great Oaks’ most recent cost of capital request (D.13-05-027), the Commission stated that “[I]f a company carries a high equity ratio, for ratemaking purposes we should necessarily consider adjusting either the return on equity or the capital structure.”⁵ In this same decision, the Commission imputed a capital structure of 70 percent common equity and 30 percent long-term debt, with a cost of debt of 7.5 percent. Great Oaks’ request would bring the capital structure closer to but not at this imputed level, reaching 85.41 percent common equity and 14.16 percent long-term debt.

² Park is a Class A water utility.

³ See D.93-10-046, D.03-12-039, Resolution W-4594, D.10-12-057, and D.13-05-027.

⁴ See D.93-10-046.

⁵ See D.13-05-027.

3.3. Request for Exemption from the New Financing Rule

The New Financing Rule set forth in D.12-06-015, replaced the Competitive Bidding Rule (CBR) authorized in Resolution F-616 in 1986. The New Financing Rule provides for exemptions based on a compelling showing by the utility that it qualifies for one of the exemptions listed in Attachment A at A-6 of D.12-06-015. In the current application, Great Oaks requests that it be exempted from the Rule because its request for new debt of \$4 million is much less than the baseline dollar amount for applicability of the New Financing Rule of more than \$42 million.

4. ORA

In its protest and testimony (Exhibit ORA-1), ORA raised concerns regarding the nature of the proposed transaction, potential conflicts of interest, the reasonableness of the proposed terms, and adherence to Commission decisions.

ORA raised concerns as to whether Great Oaks request a 7.5 percent interest rates was competitive, fair, and supported by documentation. ORA stated that Great Oaks' reliance on D.13-05-027 was not appropriate, as that decision adopted a settlement regarding an imputed cost of capital for ratemaking purposes, not an actual interest rate for long-term debt.

In particular, ORA raised concerns regarding the terms of the proposed note, including: 1) a conflict of interest, since Roeder would be on both sides of the transaction, as lender and owner of the utility; 2) the ratepayer burden of having to pay all costs associated with the proposed note if any suit, bankruptcy or other similar event occurred; 3) allowance for the payment of a higher interest rate under Federal law; 4) allowing any breach of the proposed note to be addressed in a court other than the Commission, even though the Commission

has primary jurisdiction; 5) added liability and risk to ratepayers since the lender resides in Texas; and 6) selected language in the proposed note eliminates some borrower rights.

5. All Party Settlement

On June 16, 2014, on behalf of the Parties, and in compliance with Rule 12.1(b) of the Commission's Rules of Practice and Procedure (Rules), Great Oaks served a Notice of Settlement Conference to be held on June 25, 2014. On July 29, 2014, the Parties jointly filed a motion requesting adoption of the Settlement Agreement (Appendix A to this decision). The terms agreed to in the Settlement Agreement are incorporated into Great Oaks' promissory note that it plans to issue once Commission authorization has been received (Appendix B to this decision).

5.1. Interest Rate

The Parties agreed to an interest rate for the long-term debt authorized herein of 6.5 percent, which is 100 basis points lower the rate requested by Great Oaks, resulting in a savings of interest expense of \$600,000 over the fifteen-year term of the note.

5.2. Conflicts of Interest

Throughout the settlement negotiations, Great Oaks provided assurances that no undue costs or other expenses would be passed on to ratepayers based upon the terms and conditions of the proposed promissory note. Great Oaks agreed to modify the terms and conditions of the note to confirm those assurances in writing. The modification of the terms and conditions eliminates potential conflicts of interest and the potential for unnecessary costs to be passed on to ratepayers over the full term of the note.

5.3. Reasonableness of Terms

Consistent with its assurances pertaining to the alleged conflicts of interest, Great Oaks agreed to modify the terms and conditions of the note to confirm its verbal assurances that no unnecessary or burdensome costs or liabilities would be passed on to ratepayers.

5.4. Compliance with Commission Decisions and Policies

The Parties expressly agree that the note complies with all Commission decisions and policies, including but not limited to the New Financing Rule authorized in D.12-10-015 and the Affiliate Transaction Rules for water utilities authorized in D.10-10-019.

5.5. Compliance with Statutory Requirements

The Parties agree that the note complies with all applicable statutory requirements of the Public Utilities Code, including but not limited to Pub. Util. Code §§ 816 - 830. The Parties further agree that the note does not constitute a "project" under the California Environmental Quality Act (CEQA) and no environmental impact review is required pursuant to such law.

5.6. Application and Settlement Raise No Safety Concerns

The Parties agree that A.14-01-023 and the Settlement Agreement do not raise any concerns that would impede or prevent Great Oaks from ensuring the safety of its patrons, employees, or the public. With the issuance of this financing authority, Great Oaks has the funding necessary to comply provide service to its patrons, employees, and the public in a safe manner.

5.7. Effective Date of Long-Term Debt

The Parties agree that the note shall become effective upon Commission approval of the Settlement Agreement. At that time, Great Oaks current

short-term promissory note attached to A. 14-01-023 will be canceled and replaced by the note with a term of 15 years.

5.8. Jurisdictional Matters

The Parties agree that the Settlement Agreement shall be governed by and construed in accordance with the laws of the State of California. Parties further agree to submit any claim, dispute, or request for relief regarding the Settlement Agreement to the Commission for resolution in the first instance, and if judicial relief is sought, requests will only be filed in the courts of the State of California.

6. Discussion and Conclusion

The Commission finds that the Settlement Agreement (attached as Appendix A to this decision) complies with Commission requirements for approval of settlements, because it is reasonable in light of the whole record, consistent with the law, and in the public interest.

6.1. The Settlement Agreement is Reasonable in Light of the Whole Record

The Settlement Agreement is reasonable in light of the whole record because it is an all-party settlement which resolves all concerns raised by ORA and takes into account a full record, including the application, protest, response to protest, PHC, and testimonies. The Settlement Agreement was reached after careful analysis of the issues by each party involved, all of whom are knowledgeable and experienced.

The Settlement Agreement authorizes the requested financing, and permits Great Oaks to use the proceeds thereof as authorized under Pub. Util. Code §§ 817(h) and 817(b). In addition, the interest rate of the proposed financing has been reduced and terms and conditions of the financing have been modified to address ORA's concerns regarding the jurisdiction of the Commission and compliance with Affiliate Transaction Rules. As a result, the cost associated with

the note that will be issued by Great Oaks has been reduced by more than \$600,000. Thus, we conclude the Settlement Agreement is reasonable.

6.2. The Settlement Agreement is Consistent with the Law

The Settlement Agreement is consistent with all applicable Commission decisions, rules, and regulations, including but not limited to Pub. Util. Code §§ 816-830. In particular, the Settlement Agreement is consistent with Commission rules, regulations, and decision, including but not limited to: 1) the New Financing Rule adopted in D.12-10-015; 2) the Commission's Affiliate Transaction Rules for water utilities adopted in D.10-10-019, and Pub. Util. Code § 451, which requires utilities to ensure the safety of its patrons, employees, and the public. Nothing in the Settlement Agreement contravenes statute or prior Commission decisions.

6.3. The Settlement Agreement is in the Public Interest

The agreed upon terms of the note pursuant to the Settlement Agreement resolve all items at issue in this proceeding. The Settlement Agreement is in the public interest because it is consistent with Commission policy favoring settlements of disputes if they are fair and reasonable in light of the whole record. This policy supports many worthwhile goals, including reducing the expense of litigation, conserving scarce Commission resources, and allowing parties to reduce the risk that litigation will produce unacceptable results. For these reasons, we find that the Settlement Agreement is in the public interest.

6.4. Conclusion

Approval of the Settlement Agreement avoids the cost of further litigation, and reduces the use of valuable resources of the Commission and the parties. The parties to the Settlement Agreement comprise all of the active parties in this

proceeding. Thus, the Settlement Agreement commands the unanimous sponsorship of the affected parties who fairly represent the interest affected by the Settlement Agreement.

The evidentiary record contains sufficient information for us to determine the reasonableness of the Settlement Agreement and for us to discharge any future regulatory obligations with respect to this matter. With the issuance of this financing authority, Great Oaks has the funding necessary to comply provide service to its patrons, employees, and the public in a safe manner. For all these reasons, we approve the Settlement Agreement.

7. Exemption from New Financing Rule

Given the amount of its requested debt, we find that Great Oaks qualifies for and is therefore granted an exemption from the New Financing Rule.

8. Receipt of Testimony into Record

Pursuant to Rules 11.1 and 13.8, the Parties jointly filed a motion on July 23, 2014, requesting that their exhibits and testimony be received into the record. Rule 13.8(c) allows for testimony to be offered into evidence when hearings are not held. As Great Oaks Exhibits A through E were filed with its application, they are already part of the record and so do not have to be received at this time.

Great Oak's *Rebuttal Testimony of John Roeder* as Exhibit GO-1,⁶ Great Oaks Exhibit F-*Excerpts from Testimony of Dr. J. Randall Woolridge on Behalf of the Division of Ratepayer Advocates – Cost of Capital – Application 12-05-001; 12-05-002;*

⁶ Served on June 13, 2014.

12-05-004; 12-05-005 as Exhibit GO-2,⁷ and ORA's *Direct Testimony of Jeffrey Roberts* as Exhibit ORA-1,⁸ are admitted into the record of this proceeding.

9. Fee

Whenever the Commission authorizes a utility to issue new securities, the Commission is required to charge and collect a fee pursuant to Pub. Util. Code §§ 1904(b) and 1904.1. The fee is calculated as follows:

\$4 Million of new debt	\$1,000,000	\$2 per \$1,000	\$2,000
	\$3,000,000	\$1 per \$1,000	\$3,000
Total			\$5,000

10. Financial Information

We do not make a finding in this decision on the reasonableness of Great Oaks' proposed construction program. Construction expenditures and the resulting plant balances in rate base are issues that are normally addressed in a general rate case or specific application. The authority to issue new debt herein is distinct from the authority to undertake construction.

11. California Environmental Quality Act

The California Environmental Quality Act (CEQA) applies to projects that require discretionary approval from a governmental agency, unless exempted by statute or regulation. It is long established that the act of ratemaking by the Commission is exempt from CEQA review. As stated in the California Public Resources Code, the "establishment, modification, structuring, restructuring or approval of rates, tolls, fares, or other charges by public agencies" is exempt from

⁷ Served on June 13, 2014.

⁸ Served on May 30, 2014.

CEQA.⁹ Likewise, the creation of government funding mechanisms or other government fiscal activities which do not involve any commitment to any specific project that may result in a potentially significant impact on the environment is not a “project” subject to CEQA.¹⁰

This decision does not authorize any capital expenditures or construction projects. Construction projects that Great Oaks may finance pursuant to the authority granted by this decision must undergo CEQA review as required by CEQA Guidelines Section 4004(b).

12. Category and Need for Hearings

By Resolution ALJ 176-3330, dated February 5, 2014, the Commission preliminarily determined that this was a ratesetting proceeding and that no hearings would be necessary. Pursuant to the Scoping Memo, evidentiary hearings were scheduled but subsequently removed from the calendar because a settlement was reached. We therefore affirm the original designations of a ratesetting proceeding with no hearings necessary.

13. Waiver of Comment Period

This is an uncontested matter in which the decision grants the relief requested. Accordingly, pursuant to Pub. Util. Code § 311(g)(2) and Rule 14.69(c)(2), the otherwise applicable 30-day period for public review and comment is waived.

14. Assignment of Proceeding

Michael Picker is the assigned Commissioner and Seaneen M. Wislon is the assigned ALJ in this proceeding.

⁹ Public Resource Code Section 21080(b)(8).

¹⁰ CEQA Guidelines Section 15378(b)(4).

Findings of Fact

1. Great Oaks requests authority for debt in the amount of \$4 million to reimburse its treasury of \$3,710,847.39 for capital expenditures from 2006-2013, and to pay \$289,152.61 fiscal year 2013-2014 capital additions authorized in D.13-05-020.

2. Great Oaks has no outstanding financing authority available to offset its need for debt.

3. Great Oaks' request to use the proceeds from the sale of the note to reimburse its treasury and pay for previously authorized plant additions is similar to Park's request in A.12-10-016 authorized in D.13-02-007. Instead of estimating how much Great Oaks will need in the future for proper purposes pursuant to Pub. Util. Code § 817, it expends the funds first, then requests financing when its cash reserves are depleted.

4. D.93-10-046, D.03-12-039, Resolution W-4594, D.10-12-057, and D.13-05-027 imputed a capital structures for Great Oaks, because Great Oaks actual capital structure consisted of 100 percent equity.

5. D.13-05-027 imputed a capital structure of 70 percent common equity and 30 percent long-term debt, with a cost of debt of 7.5 percent. Great Oaks' request in its application would bring the capital structure closer to but not at this imputed level, reaching 85.41 percent common equity and 14.16 percent long-term debt.

6. Great Oaks' note will have a term of 15 years.

7. Pursuant to the Settlement Agreement, the interest rate of the note will be 6.5 percent, which is 100 basis points lower than the rate Great Oaks requested in its application.

8. The necessity or reasonableness of Great Oaks' construction budget and cash requirements forecast are normally reviewed and authorized in general rate cases.

9. A public utility that requests new financing is \$42 million or less may be granted an exemption from the New Financing Rule set forth in D.12-06-015 upon a compelling showing by the utility.

10. In compliance with Rule 12.1(b), settling parties convened settlement conference and provided notice and opportunity to all parties to participate.

Conclusions of Law

1. The Commission has broad discretion under § 816 *et seq.* to determine if a utility should be authorized to issue debt securities. Where necessary and appropriate, the Commission may attach conditions to the issuance of debt securities and stock to protect and promote the public interest.

2. Pursuant to Pub. Util. Code § 816, the Commission may prescribe regulations and restrictions on the issuance of debt and equity securities issues by public utilities, and supervise and control their issuance.

3. The proper term for securities issued pursuant to Pub Util. Code § 817 is greater than 12 months.

4. Pursuant to Pub. Util. Code § 817, a public utility may only issue and use financing for selected purposes. Those purposes not listed in Pub. Util. Code § 817 may only be paid for with funds from normal utility operations.

5. The proposed new debt requested by Great Oaks is, pursuant to Pub. Util. Code §§ 817 and 818, reasonably required for proper purposes.

6. Pursuant to Pub. Util. Code § 824, the Commission may require public utilities to account for the disposition of the proceeds of all sales of stock and

debt, and establish rules to insure the disposition of such proceeds are for the purposes required by the authorizing order.

7. Excess levels of common equity burden the ratepayer with excessive rates.

8. Granting of financing authority to Great Oaks does not obligate the Commission to approve any capital projects. Review of the reasonableness of capital projects occurs as needed through the regulatory process applicable to each capital project.

9. Great Oaks should be authorized to issue up to \$4 million of new debt for proper purposes and consistent with the requirement of Pub. Util. Code §§ 816 *et seq.*

10. The Settlement Agreement is reasonable in light of the whole record, consistent with law, in the public interest, and should be adopted.

11. Great Oaks should be authorized to issue new debt via a promissory note with an interest rate of 6.5 percent and a term of 15 years.

12. Great Oaks actions regarding the Settlement Agreement or promissory note should not result in a conflict of interest or the imposition of unnecessary and/or burdensome costs onto the ratepayers of Great Oaks.

13. Great Oaks should be required to comply with all applicable Commission decisions, rules, and regulations, including but not limited to the New Financing Rule authorized in D.12-10-015 and the Affiliate Transaction Rules for water utilities authorized in D.10-10-019.

14. With the issuance of this financing authority, Great Oaks has the funding necessary to comply with Pub. Util. Code § 451, providing service to its patrons, employees, and the public in a safe manner.

15. All claims, disputes, or requests for relief regarding the Settlement Agreement or the promissory note should first be brought before the

Commission. Once such relief is exhausted, relief may be sought in the courts of the State of California.

16. The amount of Great Oaks' requested new debt complies with the exemption requirements of the New Financing Rule. Therefore, Great Oaks should be granted an exemption from the New Financing Rule.

17. Great Oaks should remit a check for \$5,000, as required by Pub. Util. Code §§ 1904(b) and 1904.1.

18. The authority granted by this decision should not become effective until Great Oaks has paid the fees prescribed by Pub. Util. Code §§ 1904(b) and 1904.1.

19. Pursuant to Public Resource Code § 21080(b)(8), the establishment, modification, structuring, restructuring or approval of rates, tolls, fares, or other charges by public agencies is exempt from CEQA.

20. Pursuant to CEQA Guidelines § 5378(b)(4), the creation of government funding mechanisms or other government fiscal activities which do not involve any commitment to any specific project which may result in a potentially significant impact on the environment is not a "project" subject to CEQA.

21. Approval of the application does not involve any commitment to any specific project that may result in a potentially significant impact on the environment; thus it is not a project subject to CEQA.

22. Rule 13.8(d) allows for testimony to be offered into evidence when hearings are not held. Therefore, Great Oaks' Exhibits GO-1 and GO-2, and ORA's Exhibit ORA-1 should be received into the record of this proceeding.

23. Application 14-01-023 should be closed.

O R D E R**IT IS ORDERED** that:

1. Great Oaks Water Company is authorized to issue up to \$4 million of new long-term debt securities through the issuance of a promissory note , for proper purposes and consistent with the requirements of Public Utilities Code §§ 816 *et seq.*

2. The Settlement Agreement filed by Great Oaks Water Company and the Office of Ratepayer Advocates on July 29, 2014, is adopted.

3. Great Oaks Water Company is authorized to issue a promissory note with an interest rate of 6.5 percent.

4. Great Oaks Water Company's Exhibits General Order (GO) -1 and GO-2, and the Office of Ratepayer Advocates' (ORA) Exhibit ORA-1 are received into the record of this proceeding.

5. Great Oaks Water Company is granted an exemption from the New Financing Rule.

6. Great Oaks Water Company (Great Oaks) actions regarding the Settlement Agreement or promissory note must not result in a conflict of interest or the imposition of unnecessary and/or burdensome costs on the ratepayers of Great Oaks.

7. All claims, disputes, or requests for relief regarding the Settlement Agreement or the promissory note issued by Great Oaks Water Company shall first be brought before the Commission. Once such relief is exhausted, relief may only be sought in the courts of the State of California.

8. The authority granted by this decision shall not become effective until Great Oaks Water Company (Great Oaks) remits the \$5,000 fee within 30 days after the effective date of this decision to the Commission's Fiscal Office. Such

payment shall be by check or money order payable to the California Public Utilities Commission and mailed or delivered to the Commission's Fiscal Office at 505 Van Ness Avenue, Room 3000, San Francisco, CA 94102. Great Oaks shall write on the face of the check or money order "For deposit to the California Public Utilities Commission Fund per **Decision 14-XX-XXX**". Great Oaks shall not use ratepayer funds for these payments.

9. Great Oaks Water Company may not use the proceeds from the new debt securities authorized by this order to fund its capital projects until Great Oaks Water Company has obtained all required approvals for the projects and any required environmental review under the California Environmental Quality Act.

10. Application 14-01-023 is closed.

This order is effective today.

Dated _____, at San Francisco, California.

ATTACHMENT A
Settlement Agreement

- 1.4. Pursuant to Rule 12.5 of the Commission's Rules of Practice and Procedure, approval of this Agreement by the Commission may not be construed as a precedent or statement of policy of any kind for or against either Party in any current or future proceedings.
- 1.5. The Parties agree to maintain the confidentiality of all settlement negotiations and communications made during the course of settlement discussions in this matter, and agree that such communications remain subject to Rule 12.6 of the Commission's Rules of Practice and Procedure.
- 1.6. This Agreement is not severable. The Parties agree that if the Commission fails to adopt this Agreement in its entirety and without condition or modification, the Parties shall convene a settlement conference within fifteen (15) days after the Commission's action to discuss whether they can resolve issues raised by the Commission's disposition of this Agreement. If the Parties cannot mutually agree to resolve the issues raised by the Commission's actions within thirty (30) days after their settlement conference, this Agreement shall be rescinded and deemed as if it were never entered into, and the Parties shall be released from any and all obligations set forth in this Agreement.
- 1.7. None of the provisions of this Agreement shall be considered waived by the Parties unless such waiver is given in writing. The failure of any Party to insist in any one or more instances upon strict performance of any of the provisions of this Agreement or to take advantage of any of their respective rights hereunder shall not be construed as a waiver of any such provision or the relinquishment of any such rights for the future, but the same shall continue and remain in full force and effect.
- 1.8. This Agreement and all the covenants set forth herein shall be binding upon and shall inure to the benefit of the respective Parties hereto, including their respective successors in interest.
- 1.9. The Parties agree without further consideration to execute and deliver such other documents and take such other actions as may be necessary to achieve the purposes of this Agreement. The Parties agree to use their best efforts to obtain Commission approval of the Agreement and to take no action and make no statements or comments contrary to the Agreement or the efforts to obtain Commission approval of the Agreement. The Parties shall request that the Commission approve the Agreement without change and find the Agreement to be reasonable, consistent with the law, and in the public interest.

2. GREAT OAKS' APPLICATION AND EVIDENCE

- 2.1. In Application 14-01-023, Great Oaks requested an Order from the Commission granting authority for Great Oaks to issue long-term debt in the amount of \$4,000,000 and use the proceeds of such debt consistent with the authority of Public Utilities Code Sections 816 – 830.
- 2.2. In support of its Application, Great Oaks presented evidence supporting the following:
 - Great Oaks is a California corporation and Class A water utility engaged principally in the business of providing potable water service for domestic, commercial, industrial,

municipal, and irrigation purposes to approximately 20,500 customers in its San José, Santa Clara County service area.¹¹

- In rate-setting proceedings for more than twenty years, the Commission has followed its policy under which long-term debt (within a desired debt-to-equity ratio) is considered favorable for water utilities because, generally, interest expenses associated with long-term debt reduce a utility's tax expenses and produce lower rates. Based upon this policy, since 1992 the Commission has adopted a capital structure for Great Oaks with "imputed" debt and interest expenses in order to reduce rates.¹²
- Most recently, in Commission Decision (D.) 13-05-027, issued May 30, 2013, the Commission adopted a settlement agreement establishing Great Oaks' cost of capital for the time period from July 1, 2013 to June 30, 2016 as shown in the table below:

Great Oaks Water Company	<u>Cost of Equity</u> 9.79percent	<u>Cost of Debt</u> 7.50percent	<u>Capital Structure</u> Imputed 30percent Debt Equity 70percent	<u>Rate of Return</u> 9.10percent
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- In D.13-05-027, the Commission authorized Great Oaks to establish a "Debt Cost Memorandum Account" to "record any additional costs, including, but not limited to outside legal counsel and consulting services, business reorganization, audit, accounting, and tax preparation, associated with issuing debt during the period of time from July 1, 2013 to June 30, 2016."¹³ Great Oaks filed an appropriate advice letter to establish such memorandum account.¹⁴
- The request for authority to issue long-term debt in this proceeding is consistent with prior Commission Decisions and with Commission policies pertaining to Great Oaks and long-term debt.¹⁵
- The request for authority to issue long-term debt in this proceeding is consistent with D.13-05-027.¹⁶
- The proposed long-term debt in the form of a promissory note from John Roeder, Great Oaks' owner and Chief Executive Officer, does not present any genuine conflicts of interest.¹⁷

¹¹ A.14-01-023, p. 3.

¹² *Id.*, p. 4.

¹³ D.13-05-027, pp. 10-11; 21-22.

¹⁴ Great Oaks' Advice Letter 230-W, filed June 5, 2013, effective July 1, 2013.

¹⁵ A.14-01-023, pp. 5-8.

¹⁶ *Id.*, pp. 8-9 and Exhibit E.

¹⁷ Rebuttal Testimony of John Roeder, pp. 2-3.

- The terms of the proposed long-term debt are fair and reasonable and impose no undue or unfair costs, burdens, or other liabilities upon Great Oaks' ratepayers recoverable through rates.¹⁸
- While Great Oaks was authorized to impute an interest rate of 7.5percent in D.13-05-027, the 7.5percent interest rate in the proposed long-term debt is still fair, commercially reasonable, and supported by bond rates and corporate debt cost rates that are higher than when the 7.5percent imputed interest rate was adopted in D.13-05-027.¹⁹
- Great Oaks' Application 14-01-023 is exempt from the provisions of the New Financing Rules in D.12-06-015.²⁰
- Great Oaks has complied with all applicable Commission Decisions, including but not limited to the Affiliate Transaction Rules in D.10-10-019 and the New Financing Rules in D.12-10-015.²¹
- Application 14-01-023 raises no concerns that would impede or prevent Great Oaks from ensuring the safety of its patrons, employees, or the public.²²
- Application 14-01-023 does not constitute a "project" within the meaning of the California Environmental Quality Act and no environmental impact review is required pursuant to such law.²³
- Great Oaks will use the proceeds of the proceeds of the long-term debt only for purposes permitted under Public Utility Code §817.²⁴
- Great Oaks' Application 14-01-023 meets all statutory requirements.²⁵
- Under Public Utilities Code §1904(b), the correct fee payable to the Commission for authorizing the long-term debt proposed in Application 14-01-023 is \$5,000.

3. ORA TESTIMONY

- 3.1. On May 30, 2014, ORA served the Direct Testimony of Jeffrey Roberts, a Public Utilities Regulatory Analyst in ORA's Water Branch. Mr. Roberts served as the project coordinator responsible for reviewing Application 14-01-023.²⁶

¹⁸ A.14-01-023, Exhibit A; Rebuttal Testimony of John Roeder, pp. 2-6.

¹⁹ Rebuttal Testimony of John Roeder, pp. 3-9 and Exhibit F.

²⁰ Application 14-01-023, p. 5.

²¹ Rebuttal Testimony of John Roeder, pp. 9-10.

²² *Id.*, p. 10.

²³ Application 14-01-023, p. 5.

²⁴ *Id.*, pp. 9-10 and Exhibit D.

²⁵ *Id.*, pp. 11-12 and Exhibits B and C.

²⁶ Direct Testimony of Jeffrey Roberts, p. 1.

3.2. In his Direct Testimony, Mr. Roberts' Testimony raised the following concerns:

- Whether the proposed 7.5percent interest rate is a competitive market rate that is fair or justifiable.²⁷
- Whether certain terms of the proposed promissory note could create conflicts of interest that may saddle ratepayers with additional liability or costs and give favorable considerations to the lender that are not reciprocated to the borrower.²⁸
- Whether it was appropriate for Great Oaks to rely solely upon the interest rate authorized in D.13-05-027 to support the reasonableness of the rate requested in A.14-01-023.²⁹
- Whether certain specified terms of the proposed promissory note appear unreasonable or created additional burden for the Commission.³⁰

3.3. Based upon the concerns raised by Mr. Roberts, he recommended that the Commission not approve Application 14-01-023 as submitted by Great Oaks.³¹

4. RESOLUTION OF ORA CONCERNS AND TERMS OF SETTLEMENT

4.1. Great Oaks and ORA conducted informal settlement negotiations during which the Parties discussed the evidence presented, ORA's concerns, and proposed resolutions to ORA's concerns. The Parties reached a tentative settlement on June 13, 2014. On June 16, 2014, on behalf of the Parties, and in compliance with Rule12(b) of the Commission's Rules of Practice and Procedure, Great Oaks filed and served a Notice of Settlement Conference on June 25, 2014. The Parties held a settlement conference pursuant to such Notice and reached a final settlement of all issues.

4.2. The Parties agree to the following terms and conditions of settlement:

- 4.2.1. Interest Rate. An interest rate of 6.5percent shall apply to any long-term debt of Great Oaks authorized in A.14-01-023. The agreed upon terms of the long-term debt, including the agreed upon 6.5percent interest rate, are set forth in the Promissory Note attached to this Agreement as Exhibit 1. This interest rate is less than requested by Great Oaks and represents a savings of interest expense of \$600,000 over the fifteen-year term of the long-term debt. By not having to apply to other potential sources of financing, Great Oaks has avoided additional costs that might have been incurred by Great Oaks in pursuing a debt issuance. The combined savings resulting from the reduction of the requested interest rate and the absence of issuance costs and fees will have a direct benefit to ratepayers over the entire term of the long-term debt.

²⁷ *Id.*

²⁸ *Id.*, p. 2.

²⁹ *Id.*

³⁰ *Id.* pp. 3-6.

³¹ *Id.*, p. 7.

- 4.2.2. Conflicts of Interest. Throughout the settlement negotiations, Great Oaks provided assurances that no undue costs or other expenses would be passed on to ratepayers based upon the terms and conditions of the proposed promissory note. Great Oaks agreed to modify the terms and conditions of the long-term debt to confirm those assurances in writing. The terms and conditions of the originally proposed long-term debt have been modified and are incorporated into the Promissory Note attached hereto as Exhibit 1. The modification of the terms and conditions eliminates potential conflicts of interest and the potential for unnecessary costs to be passed on to ratepayers over the full term of the long-term debt.
- 4.2.3. Reasonableness of Terms. Consistent with its assurances pertaining to the alleged conflicts of interest, Great Oaks agreed to modify the terms and conditions of the long-term debt to confirm its verbal assurances that no unnecessary or burdensome costs or liabilities would be passed on to ratepayers. The modified terms and conditions are set forth in Exhibit 1.
- 4.2.4. Compliance with Commission Decisions and Policies. The Parties expressly agree that the long-term promissory note attached hereto as Exhibit 1 complies with all Commission Decisions and Policies, including but not limited to the New Financing Rule in D.12-10-015.
- 4.2.5. Compliance with Statutory Requirements. The Parties expressly agree that the long-term promissory note attached hereto as Exhibit 1 complies with all applicable statutory requirements of the Public Utilities Code, including but not limited to Sections 816 – 830 thereof. The Parties further agree that the long-term debt does not constitute a “project” under the California Environmental Quality Act and no environmental impact review is required pursuant to such law.
- 4.2.6. Application and Settlement Raise No Safety Concerns. The Parties expressly agree that the Application and Settlement do not raise any concerns that would impede or prevent Great Oaks from ensuring the safety of its patrons, employees, or the public.
- 4.2.7. Effective Date of Long-Term Debt. The Parties agree that the Promissory Note attached hereto as Exhibit 1 shall become effective upon Commission approval of this Agreement. At that time, the short-term promissory note attached to Application 14-01-023 shall be canceled and replaced by the Promissory Note in Exhibit 1. The execution date of the Promissory Note shall become the date the Commission approves this settlement. The maturity date of the Promissory Note shall become fifteen (15) years later.
- 4.2.8. Jurisdictional Matters. The Parties agree that the Settlement shall be governed by and construed in accordance with the laws of the State of California. Parties further agree to submit any claim, dispute, or request for relief regarding the Settlement to the Commission for resolution in the first instance, and that if judicial relief is sought Parties will file their requests only in the courts of the State of California.

5. EXECUTION OF SETTLEMENT AGREEMENT

- 5.1. This Agreement may be executed in counterparts, each of which shall be deemed an original, and the counterparts together shall constitute one and the same instrument. By signing below, each signatory represents and warrants that he/she is authorized to sign

this Agreement on behalf of the identified Party and thereby bind such Party to the terms of this Agreement. This Agreement shall become binding and effective as of the date it is fully executed by both Parties.

Office of Ratepayer Advocates

Great Oaks Water Company

By: _____
Joseph Como
Acting Director

By: _____
John Roeder
Chief Executive Officer

Date: _____

Date: _____

(END OF ATTACHMENT A)