

Decision \_\_\_\_\_

**BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA**

In the matter of the Application of California Water Service Company (U60W), a California corporation, for an order (1) allowing issuance of \$260 Million of Mortgage Bonds to replace a like quantity of Senior Notes and (2) Clarifying D.04-09-002 to recognize an exemption from the Competitive Bidding Rule.

Application 09-01-012  
(Filed January 23, 2009)

**DECISION ON CALIFORNIA WATER SERVICE COMPANY'S  
IMPLEMENTATION OF ITS FINANCING AUTHORITY****1. Summary**

This decision grants California Water Service Company (1) a Competitive Bidding Rule (CBR) exemption for the issuance of \$100 million of authorized but unissued secured First Mortgage Bonds (secured FMB) to the extent that no one purchaser is permitted to acquire more than \$20 million in debt in a calendar year, (2) authority to exchange \$260 million of authorized and issued unsecured Senior Notes for secured FMB without obtaining additional financing authority, and (3) a CBR exemption for an exchange of \$260 million of unsecured Senior Notes for secured FMB.

**2. Background**

California Water Service Company (Cal Water) is a public utility under the jurisdiction of this Commission, providing water service in many localities in the State of California extending from Chico in the north to the Palos Verdes

Peninsula in the south. Cal Water is one of five operating subsidiaries of the California Water Service Group.<sup>1</sup> Cal Water's principal place of business is located at 1720 North First Street, San Jose, California.

### **3. Request**

Cal Water seeks (1) a Competitive Bidding Rule (CBR) exemption for the issuance of \$100 million in secured First Mortgage Bonds (secured FMB) under authority granted in Decision (D.) 04-09-002, (2) authority to exchange \$260 million of its unsecured Senior Notes for secured FMB without additional financing authority, and (3) a CBR exemption for an exchange of its unsecured Senior Notes for secured FMB.

#### **3.1. Unissued First Mortgage Bonds**

Cal Water received authorization in D.04-09-002 to issue an aggregate of \$250 million in debt and/or equity. It also received an exemption from the Commission's CBR.<sup>2</sup> Cal Water subsequently exercised \$74 million of that authority in October of 2006 through the issuance of equity to its parent company, California Water Service Group. Now, Cal Water intends to exercise up to \$100 million in secured FMB of its remaining \$176 million unissued debt and/or equity authority. First Mortgage Bonds are a type of debt authorized by D.04-09-002.

Cal Water intends to issue secured FMB over unsecured Senior Notes because they have lower interest rate demands than unsecured Senior Notes,

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<sup>1</sup> D.04-09-002 at 2.

<sup>2</sup> The Commission's CBR is set forth in Resolution No. F-616, dated October 1, 1986.

thereby reducing its overall costs of new debt issues.<sup>3</sup> This lower interest rate demand is due to (1) the secured nature of bonds, and (2) current volatility in the financial markets resulting in large spreads between secured and unsecured debt. This volatility began in the fall of 2008 and continues to this day, resulting in unsecured debt being less marketable than comparable secured debt. For example, Cal Water's bankers have estimated the current spread between secured and unsecured debt to be from 75 to 125 basis points. Based on the midpoint of this estimated range, Cal Water would experience a reduction in interest expense of approximately \$1 million per year on its proposed \$100 million secured FMB offering over an unsecured Senior Notes offering.

Due to an inconsistency of CBR exemption language between the general discussion and a Conclusion of Law in D.04-09-002, Cal Water seeks clarification of its ability to exempt this additional \$100 million of new long-term debt from the CBR. That decision's general CBR exemption discussion concluded that Cal Water should be exempted from the CBR under either of two conditions. Those conditions are (1) as long as no one series of debt issuance exceeds \$20 million *and/or* (2) no one purchaser is permitted to acquire more than \$20 million in a calendar year. However, the "*or*" in the conclusion of that CBR discussion appears to have been inadvertently dropped in Conclusion of Law 9, thereby limiting Cal Water's CBR exemption to only the issuance of any one series of debt securities that will not exceed \$20 million *and* will not total more than \$20 million in any calendar year to any one purchaser.

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<sup>3</sup> The interest rate range for new secured FMB is 5.50% to 7.50% while new unsecured Senior Notes demand an additional .75% to 1.25% interest rate spread, or 6.25% to 8.75%.

The exclusion of “*or*” from D.04-09-002’s Conclusion of Law 9 was an inadvertent error and should be corrected to be consistent with the CBR discussion in the body of that decision and should read as follows: Cal Water should be exempted from the CBR as long as no one series of debt issuance exceeds \$20 million *and/or* no one purchaser is permitted to acquire more than \$20 million in a calendar year. Therefore, the \$100 million of secured FMB to be issued by Cal Water may be exempt from the CBR to the extent that no one purchaser is permitted to acquire more than \$20 million in debt in a calendar year.

Cal Water is placed on notice that the Commission will be revisiting the CBR and may make changes to the rule that impacts Cal Water. To the extent that Cal Water has not exercised its entire authorized financing authority upon the effective date of any changes to the CBR, Cal Water will be required to comply with those changes, if applicable, in exercising its remaining financing authority.

This issuance of an additional \$100 million in secured FMB will improve Cal Water’s capital structure to approximately 49% long-term debt and 50% common equity from its current capital structure of 42% long-term debt and 58% common equity. We make no finding regarding the reasonableness of the rates, terms, and conditions of debt issued by Cal Water pursuant to the exemptions and modifications granted herein. Cal Water’s capital structure, interest rates, and associated fees will be reviewed for reasonableness in its next general rate case or cost of capital proceeding.

### **3.2. Senior Notes Exchanged for Secured Debt**

The issuance of up to \$100 million of secured FMB will trigger a provision of each unsecured Senior Note Agreement requiring Cal Water to concurrently

exchange all \$260 million of its outstanding unsecured Senior Notes for secured FMB when Cal Water issues additional secured debt. An example of this requirement is set forth in Section 5.14 of a March 1, 1999 Note Agreement attached to the Application as Exhibit B.

Cal Water is not certain that it does not need new financing authority to exchange its unsecured Senior Notes to secured FMB. However, it contends that such a conversion should not require it to seek new authority under Section 818 of the California Public Utilities Code. That code section requires a utility to obtain Commission authority to issue evidences of indebtedness payable at periods of more than 12 months.

The only difference between the unsecured Senior Notes to be exchanged for secured FMB would be the secured character of the exchanged bonds, pursuant to the unsecured Senior Note Agreements. The interest rate, maturity date, and other terms of the outstanding unsecured Senior Notes would be identical to the terms of the secured FMB for which they would be exchanged.

This exchange will not add to Cal Water's indebtedness. The currently weighted average cost of Cal Water's issued and outstanding unsecured Senior Notes is 6.01% in comparison to an estimated 6.25% to 8.75% interest rate range for issuing new unsecured Senior Notes and 5.50% to 7.50% for new secured FMB. Should we not approve this exchange, Cal Water's ratepayers would incur additional interest costs without receiving any additional benefit because Cal Water would need to issue new unsecured Senior Notes at a 6.25% to 8.75% interest rate range instead of new secured FMB at 5.50% to 7.50%.

Further, Cal Water's \$1 billion of net utility plant as of September 30, 2008 is substantially more than adequate to collateralize conversion of the unsecured Senior Notes. A synonymous exchange of existing authorized debt, as in this

instance, is not a new financing and does not trigger a need to obtain additional financing authority.

### **3.3. Proposed Exchange Exemption**

Cal Water seeks a CBR exemption from a proposed exchange of its \$260 million of unsecured Senior Notes for secured FMB due to the nature of the transaction. This is because the terms of the triggered exchange provides for existing note holders to merely exchange their unsecured Senior Notes for secured FMB, thereby precluding a bidding process to take place.

Having already concluded that a triggered exchange of the unsecured Senior Notes is not new financing, it is appropriate to determine the process by which those notes were initially issued. Cal Water's past practice has been to issue unsecured Senior Notes in issues of \$20 million or less pursuant to D.02-03-017 and D.96-10-062.<sup>4</sup> Each of its currently issued and outstanding unsecured Senior Notes is less than a \$20 million threshold for which it has been granted a CBR exemption.<sup>5</sup> This is because Ordering Paragraph 7 of the CBR exempts all bond issues of \$20 million or less from undergoing a competitive bidding process.

An exchange of the \$260 million unsecured Senior Notes for secured FMB should be exempted from the CBR because the entire \$260 million of unsecured Senior Notes were issued under an authorized CBR exemption.

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<sup>4</sup> Application at 4.

<sup>5</sup> Application at 7.

#### **4. Reporting Requirement**

General Order (GO) 24-B requires utilities to submit a monthly report to the Commission that contains, among other things: (1) the amount of debt issued by the utility during the previous month; (2) the total amount of debt outstanding at the end of the prior month; (3) the purposes for which the utility expended the proceeds realized from the issuance of debt during the prior month; and (4) a monthly statement of the separate bank account that the utility is required to maintain for all receipts and disbursements of money obtained from the issuance of debt.

The Commission has granted utilities authority to report quarterly the information required by GO 24-B to reduce their administrative cost of complying with the GO and to conform to past practice.<sup>6</sup> Cal Water should be treated no differently. Cal Water may report quarterly to the Commission the information required by GO 24-B.

#### **5. Waiver of Comment Period**

Cal Water seeks ex parte approval of its requests due to an unforeseen emergency condition. That emergency condition is an adverse credit market caused by current volatilities of the financial markets and economic conditions. This credit crisis has hampered Cal Water's ability to obtain financing for its large amount of ongoing infrastructure investment. It has also impacted Cal Water's ability to access more than \$7 million from the State of California Safe Drinking Water State Revolving Fund (SRF) because of the State of California withholding SRF payments due to its own financial crisis.

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<sup>6</sup> See, for example, D.05-08-008 (2005) at 36, D.04-10-037 (2004) at 51; and, D.03-12-052 (2003) at 11-12.

Rule 14.6(a)(6) of the Commission's Rules of Practice and Procedure allows the Commission to reduce or waive the period for public review and comment on a proposed decision due to extraordinary conditions in which time is of the essence. However, it is not necessary to rule on whether such an extraordinary condition exists because this is an uncontested matter pertaining solely to Cal Water that grants the relief sought. As such, this matter is exempt from public review pursuant to Rule 14.6(c)(2).

## **6. Category and Need for Hearings**

Cal Water requested that this matter be categorized as ratesetting. By Resolution ALJ 176-3228, dated January 29, 2009, the Commission preliminarily determined that this was a ratesetting proceeding and that a hearing would not be necessary.

Notice of the application appeared in the Commission's Daily Calendar of January 27, 2009. There was no protest to the application. Based on the record, we affirm that this is a ratesetting proceeding, and that a hearing is not necessary.

## **7. Assignment of Proceeding**

John A. Bohn is the assigned Commissioner and Michael J. Galvin is the assigned Administrative Law Judge in this proceeding.

### **Findings of Fact**

1. There was no protest to this application.
2. Cal Water received authorization in D.04-09-002 to issue an aggregate of \$250 million in debt and/or equity.
3. D.04-09-002 concluded that Cal Water may receive an exemption from the CBR.

4. Note Agreements to Cal Water's unsecured Senior Notes require an exchange of all unsecured Senior Notes for secured FMB at the time Cal Water issues additional secured FMB.

5. The interest rate, maturity date, and other terms of outstanding unsecured Senior Notes to be exchanged for secured FMB would be identical to the terms of the secured FMB for which they would be exchanged.

6. Resolution F-616 requires utilities to issue debt using competitive bids.

7. Resolution F-616 exempts bond issues of \$20 million or less from the CBR.

8. The Commission will be revisiting the CBR and may make changes that could impact Cal Water's future debt and equity financing.

9. Cal Water's past practice has been to issue unsecured Senior Notes in issues of \$20 million or less.

10. Each of Cal Water's currently issued and outstanding unsecured Senior Notes is less than a \$20 million threshold for which it has been granted a CBR exemption.

11. GO 24-B requires utilities to submit a monthly report to the Commission that contains, among other things: (1) the amount of debt and preferred stock issued by the utility during the previous month; (2) the total amount of debt and preferred stock outstanding at the end of the prior month; (3) the purposes for which the utility expended the proceeds realized from the issuance of debt and preferred stock during the prior month; and (4) a monthly statement of the separate bank account that the utility is required to maintain for all receipts and disbursements of money obtained from the issuance of debt and preferred stock.

12. The Commission has authorized utilities to report on a quarterly basis the information required by GO 24-B to reduce the utilities' administrative and compliance costs.

13. Notice of Application 09-01-012 appeared in the Commission's Daily Calendar.

14. In Resolution ALJ 176-3228, the Commission preliminarily determined that this proceeding should be categorized as ratesetting and that a hearing would not be necessary.

### **Conclusions of Law**

1. This is a ratesetting proceeding.
2. There is no need for hearings.
3. The exclusion of "or" from D.04-09-002's Conclusion of Law 9 was an inadvertent error that should be corrected to read as follows:

"Cal Water should be exempted from the CBR as long as no one series of debt issuance exceeds \$20 million and/or no one purchaser is permitted to acquire more than \$20 million in a calendar year."

4. The \$100 million of secured FMB to be issued by Cal Water may be exempt from the CBR to the extent that no one series of debt issuance exceeds \$20 million and/or no one purchaser is permitted to acquire more than \$20 million in a calendar year.

5. An exchange of unsecured Senior Notes for secured FMB is not considered new financing and does not require new authority to issue evidence of indebtedness.

6. An exchange of the \$260 million unsecured Senior Notes for secured FMB should be exempted from the CBR because the entire \$260 million of unsecured Senior Notes were issued under an authorized CBR exemption.

7. The application should be granted as requested.

8. Approval of this application does not constitute a finding of reasonableness of the resultant capital structure and cost of debt for ratemaking purposes.

9. Cal Water may report on a quarterly basis the information required by GO 24-B.

10. Cal Water should be required to comply with any subsequent changes made to the CBR, if applicable, in exercising its authorized but unused financing authority.

11. Public review and comment on the decision should be waived, pursuant to Section 311(g) of the Public Utilities Code.

12. The following Decision should be effective immediately so that Cal Water may issue as soon as needed the debt authorized herein.

## **O R D E R**

### **IT IS ORDERED** that:

1. California Water Service Company (Cal Water) is authorized a Competitive Bidding Rule (CBR) exemption for the issuance of \$100 million of authorized but unissued secured First Mortgage Bonds (secured FMB) as authorized in Decision (D.) 04-09-002, to the extent that no one series of debt issuance exceeds \$20 million and/or no one purchaser is permitted to acquire more than \$20 million in debt in a calendar year.

2. Cal Water is authorized to exchange \$260 million of authorized and issued unsecured Senior Notes, as described in the body of this Decision, for secured FMB without obtaining additional financing authority.

3. Cal Water's \$260 million exchange of unsecured Senior Notes for secured FMB is exempt from the CBR.

4. The exclusion of “or” from D.04-09-002’s Conclusion of Law 9 was an inadvertent error that shall be corrected to read as follows:

“Cal Water should be exempted from the CBR as long as no one series of debt issuance exceeds \$20 million and/or no one purchaser is permitted to acquire more than \$20 million in a calendar year.”

5. To the extent that Cal Water has not exercised its entire financing authority upon the effective date of any changes to the CBR, Cal Water shall be required to comply with those changes, if applicable, in exercising its remaining financing authority.

6. Cal Water shall make a showing of reasonableness for ratemaking purposes of the capital structure and cost of debt resulting from the transactions authorized in this decision as part of its next cost of capital or general rate case proceeding.

7. Cal Water may report on a quarterly basis all the information required by General Order 24-B with respect to debt issued pursuant to this Decision.

8. Cal Water shall comply with all applicable environmental laws and regulations when planning and implementing any capital expenditure programs that are financed, in whole or in part, with the proceeds from the debt authorized by this Decision.

9. Application 09-01-012 is closed.

This order is effective today.

Dated \_\_\_\_\_, at San Francisco, California.