

Decision **PROPOSED DECISION OF ALJ GALVIN** (Mailed 1/21/2009)

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of VALENCIA WATER COMPANY (U-342W) for Authorization to Issue and Sell Notes, or Other Evidence of Indebtedness Not to Exceed \$30,000,000.

Application 08-10-001
(Filed October 8, 2008)

**DECISION AUTHORIZING VALENCIA WATER COMPANY
TO ISSUE UP TO \$30 MILLION OF NEW LONG-TERM DEBT**

1. Summary

This decision grants Valencia Water Company (Valencia) authority to issue up to \$30 million of long-term Debt Instruments, as requested in Application 08-10-001. To the extent that Valencia has not exercised its entire requested financing authority upon the effective date of any changes to the Commission's Competitive Bidding Rule, Valencia shall be required to comply with those changes, if applicable, in exercising its remaining financing authority.

This decision also authorizes Valencia to report all Debt Instrument information required by General Order 24-B to the Commission on a quarterly basis. Further, Valencia shall continue to adhere to the conditions pertaining to affiliated transactions enumerated in Decision 07-09-026. This authority does not become effective until Valencia remits \$15,500 to the Commission's Fiscal Office.

2. Background

Valencia Water Company (Valencia) is a public utility under the jurisdiction of this Commission, providing water service to approximately 29,000

customers in portions of Los Angeles County and the City of Santa Clarita. Valencia is indirectly controlled by various private partners and companies and is subject to affiliated interest transaction rules, as detailed in Decision (D.) 07-09-026 and summarized in Appendix A to this decision. Valencia's principal place of business is located at 24631 Avenue Rockefeller, Valencia, California.

3. Protest

The Santa Clarita Organization for Planning and the Environment (SCOPE) protested the Application (A.) 08-10-001 on October 28, 2008 to prohibit preferences that favor Valencia affiliated companies and to ensure that community water resource and ratepayer needs will remain top priority as part of Valencia's issuance of new long-term debt.

SCOPE protested this application on the basis that: (1) Valencia did not disclose the rate of its existing and proposed loans in its Application, and (2) Valencia did not clearly state its financing needs. To the extent that Valencia's financing request is approved, SCOPE recommends that the new long-term debt issuances include a provision that if Valencia's stock is subsequently sold, such a sale will not trigger an acceleration of the maturity date, interest rate, or a payment of loan assumption fees.

3.1. Disclosure of Loans

Valencia's existing long-term debt consists of a single \$11 million debt issuance which was approved by the Commission pursuant to D.94-02-069 and as modified by D.94-05-067. That current debt issuance bears an interest rate of 8.00%. It was issued on June 15, 1994 and is to be retired by June 15, 2009.

Valencia proposes to issue new long-term debt by June 1, 2009 for the purpose of retiring its currently outstanding long-term debt. In this regard, Valencia executed a Letter of Commitment with Pacific Life Insurance Company.

The terms of that commitment provide for the issuance of \$12 million in 30-year Senior Secured Notes due in 2039 bearing an interest rate of 7.37%.

The remaining \$18 million balance of its requested \$30 million long-term debt authority is to be used to reimburse Valencia's treasury for monies expended and to be expended for the construction, completion, extension, and improvement of utility plant facilities through the financing vehicles identified in Valencia's Application and summarized in this decision. These long-term debt issuances are to be issued with due regard for Valencia's financial condition and requirements and then prevailing and anticipated market conditions, including competing demands for funds, existing at the time of each financing.

Valencia has fully disclosed its existing and proposed loans in its application, as identified on pages 3 and 5 of the Application and detailed in Exhibits A and E to the Application.

3.2. Financing Needs

Valencia is seeking authority to refinance \$11 million of outstanding long-term debt that is due to Pacific Life Insurance Company on June 15, 2009, and to reimburse its treasuries for monies already expended and to be expended for public utility purposes, proper purposes under Pub. Util. Code § 817¹ for issuing long-term debt. To the extent that funds are needed for prior and future public utility purposes such funds are subject to the Commission's affiliated transaction rules imposed on Valencia as enumerated in D.07-09-026.

Valencia has clearly stated its financing needs, including an immediate need to refinance its existing long-term debt by June 15, 2009. Whatever

¹ All statutory references are to the Public Utilities Code unless otherwise stated.

investments Valencia undertakes with the proceeds of Commission authorized indentures will be subject to review and evaluation in future general rate cases to consider and determine whether such investments have been prudent and provide facilities that are used and useful for Valencia's public utility ratepayers.

3.3. SCOPE's Provision for Approval

SCOPE seeks to preclude any acceleration of the maturity date, interest rate, or payment of loan assumption fees of new long-term Notes to be issued pursuant to this decision due to a reorganization of Valencia's parent holding companies Newhall Land and Farming, L.P. and LandSource Communities Development, LLC under the supervision of the United States Bankruptcy Court. (See United States Bankruptcy Court District of Delaware Docket, filed June 8, 2008.)

Valencia acknowledges that the lender of the proposed new long-term Notes required inclusion of a provision that, within ten days of a change of control, Valencia must offer to prepay the Notes with the lender afforded an option to accept or decline that offer. A change of control is defined as the existing principal shareholder of Valencia ceasing to hold a number of shares of voting common stock sufficient to cause the election of a majority of Valencia's Board of Directors.

Such an acceleration obligation is not unique. Valencia's Note Agreement executed in 1994 in connection with its existing Notes that must be retired by June 15, 2009 contains a similar acceleration obligation upon the event of a change of control.

There is no dispute that the ongoing bankruptcy reorganization of Valencia's parent holding companies may result in a change of control over Valencia as that term is defined in the Note Agreement. However, any person or

entity considering an opportunity to acquire ownership of a controlling interest in Valencia's voting common stock will need to assess and provide for the mandatory offer to prepay Valencia's debt that such a change of control would entail. Further, any change in control of Valencia will require Valencia and the party acquiring control of Valencia to obtain Commission authorization pursuant to § 854, at which time any change in the terms of long-term financing will be scrutinized.

3.4. Conclusion

SCOPE's provision for approval of this financing request is premature. The terms and conditions of any subsequent change in control of Valencia, including debt financing, are subject to review and approval of the Commission.

Valencia has fully disclosed its existing and proposed loans in its application and has clearly stated its financing needs. With Valencia's need to retire its existing 1994 Senior Secured Notes prior to June 15, 2009, time is of the essence. To the extent that the proposed financing is to be used for Public Utility purposes and is in compliance with the Pub. Util. Code § 817, the application should be approved. SCOPE's protest is without merit.

4. Request

Valencia seeks authorization to issue up to \$30 million of Debt Instruments through the issuance and sale of Debt Instruments in more than one financing. The precise amount and timing of each financing, the market to be used and method by which it will be effected, price and interest rate (which may be fixed, adjustable, or variable), and other material provisions of the Debt Instruments issued in each financing will be determined by Valencia with due regard for its financial condition and requirements and then prevailing and anticipated market conditions, including competing demands for funds, existing at the time of each

financing. Debt Instruments would consist of senior secured notes, debentures and notes, medium-term notes, and loans.

4.1. Senior Secured Notes

Secured Notes will be secured by a lien on the real and personal property of Valencia similar in terms to the Indenture filed with the Commission on July 25, 1994.

4.2. Debentures and Promissory Note

Debentures or promissory notes may be placed privately and may have fixed or floating rates of interest. Such debentures or promissory notes would be issued in accordance with an indenture, purchase agreement, or other document that would set forth the aggregate principal amount, maturity, default, and other material provisions of such debentures or promissory notes and would be secured by assets of Valencia.

4.3. Medium-Term Notes

Medium-term notes may be offered on a continuous or periodic basis. Maturities generally would range from 9 months to 15 years. They may be sold in private offerings, with fixed or floating rates, in senior or subordinated form and may be secured by assets of Valencia. Medium-term notes can be tailored to an investor's specific maturity needs so as to achieve the lowest cost of funds.

4.4. Loans

Valencia may, from time to time borrow directly from banks, insurance companies, or other sources. Valencia intends to confine its borrowing of this nature to situations designed to result in lower overall cost of funds and/or more advantageous terms and conditions than currently would be available through the issuance of other types of Debt Instruments.

5. Discussion

Valencia's request to issue Debt Instruments is subject to §§ 816 *et seq.* 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 to protect and promote the public interest.

5.1. Issuance of Debt Instruments

Valencia intends to apply the net proceeds from the proposed \$30 million issuance of Debt Instruments to retire \$11 million of senior secured notes due June 15, 2009, and to reimburse its treasury \$19 million for monies expended and to be expended for the construction, completion, extension, or improvement of utility plant facilities.

In regards to the retirement of its senior secured debt, Valencia has executed a September 2, 2008 Pacific Life Insurance Company Letter of Commitment to purchase \$12 million of 7.37% senior secured notes due 2039 from Valencia, Exhibit E to the application. This letter of commitment will expire if the transaction has not been funded by June 1, 2009.

In regards to Valencia's \$19 million request to reimburse its treasuries for capital improvements, it provided supplemental financial information to substantiate its need, Exhibit C to its application. That supplemental financial information included a five-year construction budget totaling approximately \$54 million, of which \$20 million is to be provided by internal cash flows and \$15 million from advances for construction and contributions in aid of construction.

Additional supplemental financial information provides a December 31, 2007 pro-forma capital ratio statement showing that the proposed financing will

result in a more balanced capital structure for both Valencia and its ratepayers, Exhibit B to the application. Valencia's current capital ratio of 26.5% long-term debt and 73.5% equity will improve to a 49.5% long-term debt and 50.5% equity structure.

Valencia has substantiated that the requested authorization is necessary to retire its senior secured notes due June 15, 2009 and to satisfy its needs for financing capital expenditures, a proper purpose under § 817 for issuing debt. Moreover, as required by § 818, these expenditures are not reasonably chargeable to operating expenses or income. Therefore, we will grant Valencia authority under § 816 *et seq.* to issue up to \$30 million of long-term debt for the aforementioned purposes, as detailed in the application.

Consistent with § 824, Valencia shall maintain records to identify the specific long-term debt issued pursuant to this decision, and demonstrate that proceeds from such debt has been used only for the purposes authorized by this decision.

5.2. Encumbrance of Utility Property

Valencia also seeks authority to mortgage and encumber its utility property as part of issuing its Debt Instruments similar in terms to the Indenture filed with the Commission on July 25, 1994. This request to encumber utility property is subject to § 851 which states, in relevant part, that no utility shall encumber any part its plant, system, or other property necessary or useful in the performance of its duties to the public, or any franchise or permit or right thereunder without first having secured from the Commission an order authorizing it to do so.

Consistent with previous Commission decisions, we will authorize Valencia to mortgage and encumber its utility property to improve the terms and

conditions of the Debt Instruments and to lower Valencia's overall cost of money for the benefit of ratepayers.

5.3. Competitive Bidding Rule Exemption

Resolution No. F-616, issued on October 1, 1986, requires utilities with bond ratings of "A" or higher to issue debt using competitive bids. The purpose of this requirement, known as the Competitive Bidding Rule, is to reduce the cost of debt issued by utilities.

Valencia seeks an exemption from this Competitive Bidding Rule with respect to any and all issuances of the Debt Instruments to minimize its overall costs to ratepayers. Valencia explains that a negotiated offering would lead to a lower cost as compared with competitive bidding because it is a relatively small size utility, and infrequently participates in the capital and debt markets. Valencia further explains that typically when it is necessary to issue Debt Instruments, Valencia does so through a process of loans with banks or financial institutions and private placement with institutional lenders such as large insurance companies that historically have purchased water utility company debt issues.

In support of its exemption request, Valencia explains that it is substantially smaller size, lacks a bond rating, and has never participated in the capital and debt markets. In support of its exemption request, it cites D.07-02-014 in which Golden State Water Company and D.08-07-018 in which San Gabriel Valley Water Company, water utilities substantially larger in size of Valencia, were granted exemptions from the Competitive Bidding Rule with respect to the issuance of Debt Instruments.

Valencia does not need to seek an exemption from the Competitive Bidding Rule. This is because Valencia is not subject to the Commission's

Competitive Bidding Rule at this time. Ordering Paragraph 6 of Resolution F-616 setting forth the Commission's competitive bidding policy specifically states that the Commission's Competitive Bidding rule is only applicable to utilities with bond ratings of "A" or higher. Valencia does not have a bond rating. Therefore, Valencia may negotiate and/or seek competitive bids on its requested debt instruments.

However, Valencia should be aware that the Commission will be revisiting the Competitive Bidding Rule and may make changes to the rule that impact Valencia. To the extent that Valencia has not exercised its entire requested financing authority upon the effective date of any changes to the Competitive Bidding Rule, Valencia will be required to comply with those changes, if applicable, in exercising its remaining financing authority.

We make no finding regarding the reasonableness of the rates, terms, and conditions of debt issued by Valencia pursuant to the exemptions and modifications granted herein. However, we will review the reasonableness of the interest rate and associated fees in Valencia's next general rate case or cost of capital proceeding.

5.4. Reporting Requirement

General Order (GO) 24-B requires utilities to submit a monthly report to the Commission that contains, among other things: (i) the amount of debt issued by the utility during the previous month; (ii) the total amount of debt outstanding at the end of the prior month; (iii) the purposes for which the utility expended the proceeds realized from the issuance of debt during the prior month; and (iv) 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 in order to reduce their administrative cost of complying with the GO and to conform to past practice.² Valencia should be treated no differently. Valencia may report quarterly to the Commission the information required by GO 24-B.

6. Fee

Whenever the Commission authorizes a utility to issue debt and preferred stock, the Commission is required to charge and collect a fee pursuant to §§ 1904(b) and 1904.1. A fee is not applicable on any such issues used to guarantee, take over, refund, discharge, or retire any stock, bond, note, or other evidence of indebtedness on which a fee has already been paid to the Commission. (§ 1904.1.)

Valencia expects to use \$11 million of its \$30 million request for new Debt Instruments to retire senior secured notes due June 15, 2009, which is not subject to a fee. Therefore, Valencia should pay a fee on only \$19 million of its new \$30 million debt instruments (\$30 million less \$11 million to be used to retire existing debt). If Valencia actually uses any of the \$11 million for purposes other than the retirement or refund of indebtedness previously issued, it shall notify the Commission in writing, pay the corresponding fee, and identify in its next Debt Instruments report after issuance how it used the \$11 million of long-term debt earmarked to replace existing long-term debt.

² See, for example, D.05-08-008 *mimeo.*, p. 36, D.04-10-037 (2004) *mimeo.*, p. 51; and D.03-12-052 (2003) *mimeo.*, pp. 11-12.

Valencia shall remit the required \$15,500 fee to the Commission's Fiscal Office.³ The authority granted by this decision shall not become effective until Valencia remits the \$15,500 fee to the Commission's Fiscal Office.

7. California Environmental Quality Act

Under the California Environmental Quality Act (CEQA) and Rule 2.4 of the Commission's Rules of Practice and Procedure (Rules), we must consider the environmental consequences of projects that are subject to our discretionary approval.⁴ Thus, we must consider whether approval of this application will alter an approved project, result in new projects, or change operations in ways that have an environmental impact.

Valencia expects that it will use the entire \$30 million proposed financing proceeds to retire senior secured notes due June 15, 2009, and to reimburse its treasury for monies expended and to be expended for the construction, completion, extension, or improvement of utility plant facilities. This decision does not authorize any capital expenditures or construction projects. New construction projects which Valencia intends to finance via this application should undergo a CEQA review as early as feasible in the planning process, as required by CEQA Guidelines Section 15004(b). To the extent capital expenditures are financed with the proceeds of the long-term debt issued pursuant to this decision, CEQA review should occur to the extent needed through the regulatory processes applicable to each capital project.

³ The fee is assessed on \$19 million of authorized long-term Debt Instruments as follows: (\$2 times \$1,000,000/\$1,000) plus (\$1 times \$9,000,000/\$1,000) plus (\$0.5 times \$9,000,000/\$1,000) equals \$15,500.

⁴ Pub. Resources Code Section 21080.

8. Category and Need for Hearings

Valencia requested that this matter be categorized as ratesetting. By Resolution ALJ 176-3224, dated November 17, 2008, 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 October 17, 2008. SCOPE protested the application, as described above. Based on the record, we affirm that this is a ratesetting proceeding, and that a hearing is not necessary.

9. Comments on Proposed Decision

The proposed decision of the assigned ALJ in this matter was mailed to the parties in accordance with Section 311 of the Public Utilities Code and comments were allowed under Rule 14.3 of the Commission's Rules of Practice and Procedure. Comments were filed on February 10, 2009 by Valencia and SCOPE. Reply comments were filed on February 17, 2009. These comments resulted in nonsubstantive changes to the proposed decision in this matter.

10. 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. Valencia seeks authority to issue up to \$30 million of new Debt Instruments.
2. A protest to this application was filed by SCOPE.
3. Valencia has a reasonable need to issue \$30 million of long-term debt to retire senior secured notes due June 15, 2009, and to reimburse its treasury for

monies expended and to be expended for the construction, completion, extension, or improvement of utility plant facilities.

4. Valencia seeks authority to issue Senior Secured Notes, Debentures and Notes, Medium-Term Notes, and Loans.

5. Resolution F-616 requires utilities with bond ratings of “A” or higher to issue debt using competitive bids.

6. The Commission will be revisiting the Competitive Bidding Rule and may make changes that could impact Valencia.

7. Valencia does not have a bond rating.

8. GO 24-B requires utilities to submit a monthly report to the Commission that contains, among other things: (i) the amount of debt and preferred stock issued by the utility during the previous month; (ii) the total amount of debt and preferred stock outstanding at the end of the prior month; (iii) the purposes for which the utility expended the proceeds realized from the issuance of debt and preferred stock during the prior month; and (iv) 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.

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

10. A.08-10-001 does not propose, and today’s decision does not authorize, any specific new construction or changes in use of existing assets and facilities.

11. Notice of A.08-10-001 appeared in the Commission’s Daily Calendar.

12. In Resolution ALJ 176-3224, 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 application should be granted as requested.
4. Valencia has fully disclosed its existing and proposed loans in its application and has clearly stated its financing needs.
5. SCOPE's protest is without merit.
6. Approval of this application does not constitute a finding of reasonableness of the resultant capital structure and cost of debt for ratemaking purposes.
7. The authority granted by this decision should not become effective until Valencia has paid the fees prescribed by § 1904(b).
8. Valencia should report on a quarterly basis the information required by GO 24-B.
9. Valencia should continue to adhere to the conditions pertaining to affiliated transactions as enumerated in D.07-09-026.
10. Valencia should not use the proceeds from the debt authorized by this decision to fund capital projects until Valencia has obtained any required authorization for the projects, including any required environmental review under CEQA.
11. Valencia is not subject to the Commission's competitive bidding rule at this time.
12. Valencia should be required to comply with any subsequent changes made to the Competitive Bidding Rule, if applicable, in exercising its authorized but unused financing authority.

13. The authority granted by this decision should not become effective until Valencia has paid the fees prescribed by §§ 1904(b) and 1904.1.

14. The following Decision should be effective immediately so that Valencia may issue as soon as needed the debt authorized herein.

O R D E R

IT IS ORDERED that:

1. Valencia Water Company (Valencia) is authorized to issue \$30 million of negotiated long-term debt to retire its senior secured notes due June 15, 2009, and to reimburse its treasury for monies expended and to be expended for the construction, completion, extension, or improvement of utility plant facilities.

2. To the extent that Valencia has not exercised its entire requested financing authority upon the effective date of any changes to the Competitive Bidding Rule, Valencia shall be required to comply with those changes, if applicable, in exercising its remaining financing authority.

3. Valencia may encumber utility property to secure Debt Instruments authorized by this Decision to improve the terms and conditions of the Debt Instruments and to lower Valencia's overall cost of money for the benefit of ratepayers.

4. Valencia shall make a showing of reasonableness for ratemaking purposes of the capital structure and cost of debt resulting from the transactions, including retirement of debt, as part of its next cost of capital or general rate case proceeding.

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

6. Valencia shall continue to adhere to the conditions pertaining to affiliated transactions as enumerated in Decision 07-09-026.

7. Valencia shall pay a fee on only \$19 million of its new \$30 million debt instruments (\$30 million less \$11 million to be used to retire existing debt). If Valencia actually uses any of the \$11 million for purposes other than the retirement or refund of indebtedness previously issued, it shall notify the Commission in writing, pay the corresponding fee, and identify in its next Debt Instruments report after issuance how it used the \$11 million of long-term debt earmarked to replace existing long-term debt.

8. Valencia shall remit to the Commission's Fiscal Office a check for \$15,500 as required by § 1904(b) of the Pub. Util. Code. The decision number of this Decision shall appear on the face of the check.

9. The authority granted by this Decision shall not become effective until Valencia remits \$15,500 to the Commission's Fiscal Office.

10. Valencia 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.

11. Application 08-10-001 is closed.

This order is effective today.

Dated _____, at San Francisco, California.