

WATER/KPC/FLC/KOK/DLW/RHG

Decision 06-01-019 January 12, 2006

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

In the Matter of the Application of PARK
WATER COMPANY U-314-W, for an Order
authorizing it to issue evidence of indebtedness
(First Mortgage Bonds).

Application 05-09-028
(Filed September 23, 2005)

OPINION ON DEBT ISSUE

1. Summary

This decision grants Park Water Company (Park) the authority requested in Application (A.) 05-09-028 (Application).

Park requests authority, pursuant to Pub. Util Code § 816 *et. seq.*¹, to issue up to \$15,000,000 of its First Mortgage Bonds (Bonds), to reimburse its treasury for previous capital expenditures in its Central Basin Division and its subsidiaries, and to pay off certain bonds previously issued.

2. Background

Park is a California corporation and operates as a public utility water system in the southeastern and southern sections of Los Angeles County (Central Basin Division). Park has a wholly-owned public utility subsidiary in California, Apple Valley Ranchos Water Company (Apple Valley Ranchos), that operates a public utility water system in, and near, the Town of Apple Valley in San Bernardino County. Apple Valley also

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

operates Jess Ranch that provides irrigation services, and is not a water system.

In addition to its operations in California, Park has a wholly owned public utility subsidiary in Montana, Mountain Water Company (Mountain Water), that provides water service within and around the community of Missoula, Montana.² Mountain Water is a regulated utility under the jurisdiction of the Montana Public Service Commission.

Park's consolidated income statement for the seven months ending July 31, 2005, shown as Exhibit A to the Application, presents total operating revenues of \$24,698,268 and net income before taxes of \$430,465. Park's California operating revenues of \$17,712,000, as of July 31, 2005, is 71.71% of total operating revenues.³

² By Decision 90653, dated August 14, 1979, in A.58856, the Commission granted Park authority to issue a promissory note in the principal amount of \$3,250,000, for the purpose of acquiring the stock and control of Mountain Water from the Montana Power Company.

³ Park's operating revenues consist of \$10,672,000 from the Central Basin Division, \$6,953,000 from Apple Valley Ranchos and \$87,000 from Jess Ranch.

The consolidated balance sheet as of the same period, shown as part of Exhibit A is summarized as follows:

<u>Assets</u>	<u>Amount</u>
Net Plant	\$132,193,012
Current and Accrued Assets	21,106,503
Deferred Debts	<u>4,896,371</u>
Total Assets	<u>\$158,195,886</u>
<u>Liabilities & Stockholders Equity</u>	
Capital Stock and Surplus Profit	\$ 51,064,803
Long-Term Debt	42,385,697
Current and Accrued Liabilities	9,532,450
Deferred Credits	27,498,061
Advances for Construction	21,998,450
Contributions in Aid of Construction	<u>5,716,425</u>
Total Liabilities & Stockholders Equity	<u>\$158,195,886</u>

Park's existing long-term debt consists of: (i) approximately \$39.7 million First Mortgage Bonds issued to Pacific Life Insurance Company (Pacific Life), American United, Nationwide Insurance, State Life Insurance, and Pioneer Life Insurance, under an Indenture, dated November 1, 1973, between Park and certain Trustees (Original Indenture), as supplemented, amended and restated by the Eighth Supplemental Indenture, dated as of February 1, 2002 (Restated Indenture), and supplements thereto, and (ii) \$2,469,236 of 10 to 15 years unsecured notes issued to repurchase Park's outstanding common stock from a limited number of minority stockholders, as authorized by Decision (D.) 97-03-018 and amended by D.01-04-032.

3. Notice and Protests

Notice of the filing of the Application appeared on the Commission's Daily Calendar of September 27, 2005. No protests have been received.

4. Description of Financing

Park is currently in the process of completing its negotiations with Pacific Life regarding the terms of the Bonds. Park plans to retire two bonds previously issued by Park to Pacific Life (Prior Bonds), and reimburse its treasury for capital expenditures funded by earnings. The Prior Bonds bear interest rates of 10.70% and 10.96%, respectively.

Park expects that the Bonds will mature 30 years after their issuance date. Based on negotiations with Pacific Life, Park anticipates an interest rate of 150 basis points over 30 year treasury rates. The actual interest rate will be set at the time of execution of Pacific Life's Commitment letter to purchase the Bonds. Park anticipates a coupon rate of approximately 6%.

The Bonds will be a new series of First Mortgage Bonds, issued under and secured by the Original and Restated Indenture, and to be further supplemented by the Tenth Supplemental Indenture.⁴ Park anticipates that the Tenth Supplemental Indenture will be similar in form and content to the Ninth Supplemental Indenture, with such changes or additions that Park may determine necessary or appropriate, in order to meet current market demands.⁵

Park has pledged substantially all of its property as collateral for the bonds under its trust indentures.

⁴ On May 15, 2002, Park issued the Ninth Supplemental Indenture for its most recent issuance of First Mortgage Bonds, under the authority granted by D.92-02-042.

⁵ The Ninth Supplemental Indenture is shown as Exhibit B to the Application.

5. Cash Requirements Forecast

Park Water’s consolidated 3-year cash requirements forecast are summarized as follows:

	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>Total</u>
Funds for construction	\$10,674,973	\$ 9,921,532	\$ 9,989,915	\$30,586,420
Bonds, Notes retired	4,900,000	0	0	4,900,000
Refunds of advances	<u>860,000</u>	<u>1,010,000</u>	<u>1,110,000</u>	<u>2,980,000</u>
Total Cash required	\$16,434,973	\$10,931,532	\$11,099,915	\$38,466,420
Estimated cash available				
from internal sources	<u>\$ 7,551,722</u>	<u>\$ 7,718,022</u>	<u>\$ 8,214,034</u>	<u>\$23,483,778</u>
External financing	<u>\$ 8,883,251</u>	<u>\$ 3,213,510</u>	<u>\$ 2,885,881</u>	<u>\$14,982,642</u>

Park’s cash requirements forecast indicates that it would require funds from external sources amounting to \$14,982,642 for 2006 through 2008. Park estimates that \$4.9 million is needed to retire part of its debt, approximately \$2 million relates to cash needed for the operations of Mountain Water, and \$8 million relates to the cash needed for the operations of the Central Basin Division and Apple Valley. Park indicates that the requested authority in this Application for the issuance of \$15 million debt is necessary to help meet the forecasted cash requirements.

6. Capital Structure

Park states that both this Commission and the Montana Public Service Commission recognize a single consolidated capital structure for Park and all of its subsidiaries and that both Commissions use this single consolidated capital structure for ratemaking purposes.

For example, in D.03-08-069, dated August 21, 2003, in Apple Valley’s A.02-03-046, the Commission recognized that Park’s subsidiaries have a capital structure equivalent to Park’s consolidated capital structure. The Commission pointed out that since Park serves as the de-facto

borrower for its subsidiaries, by providing a source of capital through inter-company transactions, there is in effect one common capitalization for Park and its subsidiaries.

Park indicates that it serves as a common source of any necessary debt capital for its subsidiaries as, because of its size, it can acquire debt more easily and at more favorable rates than could any of its subsidiaries individually. Park provides financial support for its subsidiaries, as well as administrative, accounting, engineering, and data processing support. Although Park has outside debt, its subsidiaries do not.

Park's consolidated capital ratios are shown below, as recorded, and as adjusted, giving a proforma effect for the transactions listed below:

	(In thousands)					
	<u>Recorded</u>		<u>Adjustments</u>	<u>Proforma</u>		
Long-term debt	\$39,564	42.50%	10,100(A)	\$ 49,664	48.13%	
Other notes payable, net	<u>2,469</u>	<u>2.65%</u>	<u>-</u>	<u>2,469</u>	<u>2.39%</u>	
Subtotal	\$42,033	45.15%	10,100	\$ 52,133	50.52%	
Common Stock & paid-in capital	\$ 2,573	2.76%	-	\$ 2,573	2.49%	
Retained Earnings	<u>48,491</u>	<u>52.09%</u>	<u>-</u>	<u>48,491</u>	<u>46.99%</u>	
Total Capitalization	<u>\$93,097</u>	<u>100.00%</u>	<u>10,100</u>	<u>\$103,197</u>	<u>100.00%</u>	

A. Long-term Debt:

- (1) Issuance of \$15,000,000 Bonds requested in this Application.
- (2) Payment of approximately \$4,900,000 of Prior Bonds.

Park's authorized capital structure, as shown in D.03-12-040 dated, December 18, 2003, consists of 59.98% common equity and 40.02% long-term debt.

While it appears that approving Park's financing request will not materially change Park's capital structure to the detriment of ratepayers,

capital structures are normally subject to review in cost of capital or general rate case proceedings. We will not, therefore, make a finding in this decision on the reasonableness of the projected capital ratios for ratemaking purposes.

7. Use of Proceeds

Park proposes to use \$10,100,000 to reimburse its treasury for previous capital expenditures in its Central Basin Division and its subsidiaries, and approximately \$4,900,000 to pay off or retire Prior Bonds.

a. Capital Expenditures

As presented in Exhibit C to the Application, Park’s consolidated capital expenditures, funded from earnings, from January 1, 1998 through September 30, 1999, are as follows:

<u>Division</u>	<u>1998</u>	<u>1999</u>	<u>Total</u>
Corporate	\$ 909,900	\$ 307,900	\$ 1,217,800
Central Basin	1,237,300	1,314,500	2,551,800
Mountain-Missoula	2,273,600	1,839,700	4,113,300
Mountain-Superior	54,000	24,600	78,600
Mountain-Linda Vista	156,700	63,400	220,100
Apple Valley Ranchos	<u>1,578,400</u>	<u>2,164,100</u>	<u>3,742,500</u>
Total	<u>\$6,209,900</u>	<u>\$5,714,200</u>	<u>\$11,924,100</u>

Staff reviewed these expenditures, for 1998 and 1999 regarding Corporate, Central Basin Division, and Apple Valley Ranchos, by comparing them with plant balances authorized in its general rate cases and plant additions shown in Park’s and Apple Valley’s annual reports to the Commission for the years in question.⁶ Staff was able to verify that

⁶ See Park’s and Apple Valley Ranchos’ 1998 and 1999 Annual Reports. Also see Park’s, D.97-11-061 (A.97-03-032), dated November 19, 1997 and Apple Valley Ranchos’ D.99-03-032 (A.98-03-024), dated March 18, 1999.

these capital expenditures were documented in the annual reports and the plant balances adopted in the general rate cases.

Communications with the Montana Public Service Commission were undertaken to verify Mountain Water’s 1998 and 1999 plant improvements and to solicit concerns that the Montana Commission may have in reference to Park’s debt Application. The Montana Commission provided Order No. 6264b in Docket No. D2000.7.112 that addressed Mountain Water’s general rate increase based on a 1999 test year. The order stated that since 1997, Mountain Water indicated that it has made significant investments in new mains, replacement mains, looping for fireflows and emergency preparedness, and both Mountain Water and the Montana Consumer Counsel provided testimonies that resulted in the establishment of just and reasonable rates. No other data or concerns were provided by the Montana Commission to this Commission.

These facts, along with the lack of financing authorization for the 1998 and 1999 construction expenditures, provide, in part, some assurance that the construction was funded from the treasury and such funds were not used for maintenance of service and replacements.

Park estimates a construction budget of \$30,586,420, for the years 2006 through 2008, as shown in its supplemental information to the Application. Park estimates the construction budget will be used as follows:

<u>Division</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>Total</u>
Corporate	\$ 358,233	\$ 309,598	\$ 348,183	\$ 1,016,014
Central Basin	2,842,000	2,889,000	2,934,000	8,665,000
Mountain Water	3,526,240	3,058,634	3,031,232	9,616,106
Apple Valley Ranchos	<u>3,948,500</u>	<u>3,664,300</u>	<u>3,676,500</u>	<u>11,289,300</u>
Total	<u>\$10,674,973</u>	<u>\$9,921,532</u>	<u>\$9,989,915</u>	<u>\$30,586,420</u>

While the construction, completion, extension or improvement of a company’s facilities is a proper use for financing authority, pursuant to § 817(b), we will not make a finding in this decision on the reasonableness of Park’s proposed construction program. The reasonableness of construction expenditures and the resulting plant balances in ratebase are issues that are normally addressed in general rate cases.

b. Retirement of Prior Bonds

Park proposes to retire the following Prior Bonds issued to Pacific Life:

<u>Series</u>	<u>Date Issued</u>	<u>Amount</u>	<u>Maturity</u>	<u>Outstanding Principal Amount</u>
10.96%	2/01/88	\$3,500,000	11/01/12	\$ 1,684,000.00
10.70%	1/15/91	\$4,500,000	1/15/16	\$ <u>3,232,460.26</u>
Total				\$ <u>4,916,460.26</u>

While issuing Bonds with an approximate 6% rate to replace Prior Bonds with rates close to 11% appears beneficial, debt costs are normally subject to review in cost of capital or general rate case proceedings.

Therefore, we will not make a finding in this decision on the reasonableness of the debt costs for ratemaking purposes.

8. Affiliate Transactions

The Application states that Park borrows funds required for the operations of its Central Basin Division and subsidiaries. Park notes that it transfers capital as needed to its division and subsidiaries through inter-company transactions, thereby allowing the subsidiaries to benefit from Park’s greater borrowing power and ability to obtain debt at a lower cost.

Unlike certain Class A water utilities, the Commission has not adopted affiliate transactions rules that govern the relationship between

Park and its subsidiaries, other than the reporting guideline adopted by the Commission in D.04-06-018:

Identify and explain all transactions with corporate affiliates involving utility employees or assets, or resulting in costs to be included in revenue requirement. Include all documentation, including a list of all such contracts, and accounting detail necessary to demonstrate that any services provided by utility officers or employees to corporate affiliates are reimbursed at fully allocated costs.⁷

It is in the public interest to ensure that the utility and its ratepayers are not subsidizing affiliated operations. Therefore, in addition to the reporting guideline adopted in D.04-06-018, we adopt the following rules to govern transactions between Park and its subsidiaries:

1. Debt that is issued by Park and subsequently utilized by affiliated companies shall not be issued or guaranteed by Park without prior approval by the Commission.
2. Park shall maintain its accounting records in accordance with Generally Accepted Accounting Principles and, where appropriate, the Commission's Uniform System of Accounts.
3. Park and each of its affiliated companies shall allocate costs between themselves in such a manner that ratepayers of Park's Central Basin District and Apple Valley Ranchos will not subsidize any other affiliate or subsidiary of Park. Park shall include and explain its methodology in its general rate case filings.
4. Park shall comply with any applicable regulations in Montana relative to this debt authorization.

⁷ See D.04-06-018, p.9 of the Appendix, in Rulemaking 03-09-005, dated September 4, 2003.

5. Park's financing transactions for any of its affiliates or subsidiaries should not increase costs, or decrease service to its California jurisdictional customers.

If in the future, this Commission develops and authorizes rules, in particular, affiliate transaction rules that apply to such transactions, those new rules may apply, in addition to or in place of those authorized today.

9. Loan Approval

Park's request to issue Bonds is subject to § 816 *et seq.*, which provide, in relevant part, as follows:

Section 816: The power of public utilities to issue... evidences of indebtedness and to create liens on their property situated within this State is a special privilege, the right of supervision, regulation, restriction, and control of which is vested in the State, and such power shall be exercised as provided by law under such rules as the commission prescribes.

Section 817: A public utility may issue stocks and stock certificates or other evidence of interest or ownership, and bonds, notes, and other evidences of indebtedness payable at periods of more than 12 months after the date thereof, for any one or more of the following purposes and no others...

(b) For the construction, completion, extension, or improvement of its facilities...

(d) For the discharge or lawful refunding of its obligations...

(h) For the reimbursement of money's actually expended from income or from any other money in the treasury of the public utility not secured by or obtained from the issue of stocks or stock certificates or other evidence of interest or ownership, or bonds, notes, or other evidences of indebtedness of the public utility, for any of the aforesaid purposes except maintenance of service and replacements, in cases where the applicant has kept its accounts and vouchers for such expenditures in such manner as to enable the commission to ascertain the amount

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of money so expended and the purposes for which such expenditure was made.

Section 818:

No public utility may issue stocks and stock certificates, or other evidence of interest or ownership, or bonds, notes or other evidences of indebtedness payable at periods of more than 12 months..., in addition to the other requirements of law it shall first have secured from the commission an order authorizing the issue, stating the amount thereof and the purposes to which the issue or the proceeds thereof are to be applied...

Section 851:

No public utility... shall sell, lease, assign, mortgage, or otherwise dispose of or encumber the whole or any part of its... plant, system, or other property necessary or useful in the performance of its duties to the public....without first having secured from the commission an order authorizing it so to do.

The Commission has broad discretion under § 816 *et seq.*, to determine if a utility should be authorized to issue debt. The primary standard used by the Commission is whether a utility has demonstrated a reasonable need to issue debt for proper purposes⁸.

The provisions of § 817(h) are silent about the time within which a utility may request funding for the reimbursement of treasury for capital expenditures. Historically, Park issues bonds to reimburse treasury within a few years of the expenditures. D.93-01-022 dated January 8, 1993 in A.92-09-048, authorized Park to issue bonds to reimburse treasury for funds expended from earnings and used for capital projects from July 1, 1990 through June 30, 1992. D.95-08-060, dated August 11, 1995, in A.95-05-027, authorized Park to issue bonds to reimburse its treasury for capital

⁸ The term “proper purposes” means any expenditure that is necessary or proper to promote legitimate objects of a public utility of the type concerned. (207 Cal 630 (1929).)

expenditures funded by earnings from 1992 through 1994. In Park's A.01-12-011, the Commission issued D.02-02-042, dated February 21, 2002, which permitted the reimbursement of treasury for capital expenditures incurred from April 1, 1996 to December 31, 1997. Park did not make any debt filings between 2002 and the early part of 2005.

Park's proposed use of proceeds falls within the purview of §§ 817(b), (d) and (h). Neither the Code nor prior financing authorizations, set a time limit for requesting the reimbursement of treasury through debt issues, however, we encourage Park to make its funding requests on a timely basis, within five years of the capital expenditure(s). If in the future, Park finds itself in a situation where a financing transaction is deferred over a significant period of time because of unfavorable interest rates, or simply because it does not require funding, we expect Park to provide in its next financing filing, the necessary records and vouchers to ascertain the amount being reimbursed, and the purpose for which the capital expenditure was made.

10. Categorization and Need for Hearings

In Resolution (Res.) ALJ 176-3160 dated October 6, 2005, the Commission preliminarily categorized this Application as ratesetting, and preliminarily determined that hearings were not necessary. No protests have been received. Given these developments, a public hearing is not necessary, and there is no need to alter the preliminary determinations made in Res. ALJ 176-3160.

11. 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), the

otherwise applicable 30-day period for public review and comment is being waived.

12. Fees

Whenever the Commission authorizes a utility to issue debt, the Commission is required to charge and collect a fee in accordance with § 1904(b).

Section 1904(b) states in part that a fee need not be paid on such portion of any such issue as may be used to guarantee, take over, refund, discharge or retire any note or other evidence of indebtedness on which a fee has been paid to the Commission. Of the \$15,000,000 debt requested, \$4,900,000 will be used to pay off Prior Bonds whereby the fee was previously paid to the Commission. The amount subject to the fee is therefore \$10,100,000.

Pursuant to § 1904(b), Park should pay the fee of \$11,050⁹.

13. Assignment of Proceeding

Kevin P. Coughlan is the assigned Examiner in this proceeding.

Findings of Fact

1. Park is a public utility subject to the jurisdiction of this Commission.
2. Park's capital projects in its Central Basin Division and its subsidiaries from January 1, 1998 through September 30, 1999, were funded from Park's earnings and its treasury.
3. Park needs external funds for the purposes set forth in the Application.

⁹ The amount subject to the fee is \$10,100,000. The fee is determined as follows: $(\$2 \times (1,000,000/1,000)) + (\$1 \times (9,000,000/1,000)) + (0.50 \times (100,000/1,000)) = \$11,050$.

4. The proposed issuance of Bonds is for proper purposes not adverse to the public interest.

5. The execution of a Supplement or a Restated Indenture is reasonably required to facilitate completion and documentation of the authority granted in this Decision.

6. The money, property, or labor to be procured or paid for by the proposed issuance of Bonds is reasonably required for the purposes specified in the Application.

7. Mountain Water is a wholly-owned subsidiary of Park, and provides water service within and around the community of Missoula, Montana

8. This Commission and the Montana Public Service Commission recognize a single consolidated capital structure for Park and all of its subsidiaries for ratemaking purposes.

9. The Commission does not, by this decision, determine that the prior capital expenditures, construction budget, debt costs and capital ratios presented herein are necessary or reasonable for purposes of setting rates.

10. Authorizing Park to encumber utility assets, as required to secure the debt issue, is for proper purposes and is not adverse to the public interest.

11. Notice of the filing of the Application appeared on the Commission's Daily Calendar of September 27, 2005. There is no known opposition to this Application, and the authority requested should be granted.

Conclusions of Law

1. A public hearing is not necessary.

2. The Application should be granted to the extent set forth in the order that follows.

3. The proposed issue of Bonds is for lawful purposes and the money, property, or labor to be obtained is required for these purposes.

4. Section 817 allows a public utility to issue stocks or other evidences of indebtedness payable at periods of more than 12 months for the construction, completion, or improvement of its facilities; for the discharge or lawful refunding of its obligations; and for the reimbursement of moneys expended from income or its treasury not obtained from debt issues.

5. Park's financing transactions for Mountain Water should not affect California jurisdictional customers.

6. Park Should pay the fee determined in accordance with § 1904(b).

7. The following order should be effective on the date of signature.

ORDER

IT IS ORDERED that:

1. On or after the effective date of this order, Park Water Company (Park), upon terms and conditions substantially consistent with those set forth or contemplated in Application 05-09-028 (Application), is authorized to (a) issue its First Mortgage Bonds (Bonds) in the aggregate principal amount not to exceed \$15,000,000, and (b) execute and deliver the Tenth Supplemental Indenture relating to the Bonds.

2. Park may (a) refinance \$4,900,000 of certain bonds previously issued by it to Pacific Life Insurance Company, as described in the

Application, and (b) reimburse its treasury the amount not exceeding \$10,100,000, for capital expenditures funded through earnings.

3. Park shall keep and maintain copies of the First Mortgage Bond Form, the original and supplemental indentures relating to this order, and within thirty days from request provide copies to the Water Division's Utility Audit, Finance and Compliance Branch (UAFCB).

4. This order does not authorize any capital expenditures or construction projects.

5. Park shall observe the conditions pertaining to affiliate transactions enumerated in Decision 04-06-018 and Section 8 of this Decision.

6. On or before the 25th day of each month, Park shall file with the Water Division's UAFCB the reports required by General Order Series 24.

7. The authority granted by this order shall become effective when Park Water pays \$11,050, as required by Pub. Util. Code § 1904(b).

8. A copy of this Decision shall be mailed to:

Dave Burchett
State of Montana
Public Service Commission
1701 Prospect Avenue
P.O. Box 202601
Helena, MT 59620-2601

9. This proceeding is closed.

This order is effective today.

Dated January 12, 2006, at San Francisco, California.

MICHAEL R. PEEVEY
President
GEOFFREY F. BROWN

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DIAN M. GRUENEICH
JOHN A. BOHN
RACHELLE B. CHONG
Commissioners