

WATER/KPC/KOK/DLW/AML

Decision 07-01-015 January 11, 2007

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

In the Matter of the Application of SAN JOSE
WATER COMPANY U-168-W for Authority to
Issue and Sell Debentures not exceeding, the
Aggregate Amount of \$50,000,000 and to Execute
and Deliver Loan Agreement(s).

Application 06-08-025
(Filed August 28, 2006)

OPINION GRANTING AUTHORITY TO ISSUE DEBT SECURITIES

1. Summary

This decision grants San Jose Water Company (SJWC) the authority requested in Application (A.) 06-08-025 (Application), with certain conditions.

SJWC requests authority, pursuant to §§ 817, 818, 823 and 851 of the California Public Utilities (Pub. Util.) Code to:

1. Issue and sell, on or before December 31, 2009, for cash up to \$50,000,000, debt securities (Debentures) consisting of Senior Notes with or without insurance, Medium Term Notes, Project Specific Financing, First Mortgage Bonds and/or Debt Securities relating to participation in governmental or agency tax free debt financing;
2. Execute and Deliver Loan Agreement(s); and

3. Be exempted from the Commission's Competitive Bidding Rule in relation to the sale of debt.¹

By this decision, we do not grant authority to SJWC to acquire any water systems. If SJWC intends to acquire a water system, it must request authority by separate application. However, should SJWC obtain all necessary authorizations, including from this Commission to purchase water system(s), then it may use the proceeds from the funding we authorize today. As was discussed with SJWC, we will limit SJWC's authority to issue debentures only up to a 30-year term.

2. Background

SJWC is a Class A water utility subject to the jurisdiction of this Commission. SJWC provides water to a population of approximately one million residents through approximately 212,500 service connections. It serves the cities of San Jose, Campbell, Cupertino, Saratoga, Monte Sereno, the Town of Los Gatos, and in the adjacent territory within the County of Santa Clara.

For the twelve months ending June 30, 2006, SJWC reported total operating revenues of \$174,099,724 and net income of \$21,597,104, as shown in its Statement of Income, attached as Exhibit I, page 1 of 3 to the Application. The ending retained earnings amounted to \$135,886,700.

¹ Public Utilities are required to publicly invite written sealed bids for the purchase of their securities (with certain exceptions), and to sell their securities at the highest price obtainable.

SJWC's Consolidated Balance Sheet at June 30, 2006, shown also as part of Exhibit I, page 2 of 3, and Exhibit I, page 3 of 3, is summarized as follows:

(Dollars in thousands)

<u>Assets</u>	<u>Amount</u>
Net Property, Plant and Equipment	\$468,077
Current Assets	51,442
Other Assets	27,064
Utility Plant Held for Future Use	215
Non-Utility Property	<u>252</u>
Total Assets	<u>\$547,050</u>
 <u>Capitalization and Liabilities</u>	
Paid In Capital	25,215
Other Comprehensive Income	(3,666)
Retained Earnings	<u>135,887</u>
Total Stockholders' Equity	\$157,436
 Current Liabilities	 \$ 46,549
Long-Term Debt	131,927
Advances for Construction	67,704
Contributions in Aid of Construction	90,843
Postretirement Benefit	16,420
Deferred Income Taxes	31,746
Other Liabilities and Deferred Credits	<u>4,425</u>
Total Liabilities	\$389,614
 Total Commitments and Contingencies	 <u>\$547,050</u>

3. Description of Requested Debt Securities

The Application states that SJWC plans to issue up to \$50,000,000 debt securities (Debentures) consisting of Senior Notes with or without insurance, Medium Term Notes, Project Specific Financing, First Mortgage

Bonds and/or Debt Securities relating to participation in governmental or agency tax free debt financing.

a) Debentures

SJWC plans to sell the debentures to an institutional investor or investors for investment purposes rather than for resale to the public. Because of changing market conditions, SJWC requests Commission authority to offer the debentures, with interest rates based on market conditions existing at the time of negotiating the terms. SJWC intends to sell the debentures for cash at 100% of par value, plus accrued interest from the date of issuance.

SJWC anticipates that the debentures would range in maturity, from 20 or more years, and would be redeemable at the option of SJWC at any time prior to maturity, subject to certain restrictions. SJWC indicates that redemption restrictions may state a redemption price ranging from an amount equal to the principal amount plus a premium, expressed as a percentage of the principal amount, commencing with the 12-month period beginning with the date of the debt issuance or under some other type of "make-whole" formula or utilizing a combination of both methods, plus in each case, accrued interest.²

b) Senior Notes

Senior Notes are generally unsecured debt which have a lower rating than First Mortgage Bonds, but a higher rating than general creditors. Except Notes G and H, SJWC's Senior Notes do not have

² The Make-Whole Amount would be equal to the excess amount of the original interest payments to the lender over (in excess of) the amount of interest payments which would be payable based on the lender's current interest rate at the redemption date. The Make-Whole Amount may in no event be less than zero. For purposes of the discounted value, the rate is equal to the interpolated yield of a U.S. Treasury security with maturity equal to the remaining life of the called bonds plus 50 basis points.

sinking fund payments, and the entire principal is due at maturity. Senior notes may vary between short-term, medium-term to long-term.

c) Medium-Term Notes

These are generally sold in public or private offerings, with fixed or floating rates, in senior or subordinated form. Medium-Term Notes are generally sold on a best efforts or agency basis and can be tailored to an investor's specific maturity needs so as to achieve the lowest cost of funds.

d) Mortgage Bonds

Mortgage bonds are issued with collateral (usually a lien on the property, which gives ownership right to the asset (title) in the event of foreclosure) and can be administratively cumbersome. SJWC has not issued any Mortgage Bonds for about 10 Years.

e) Project Financing

Project financing means that the funding is only for a specific project. Safe Drinking Water State Revolving Fund loans, as well as other types of governmental financing, are project specific and usually tax free.

f) Discussion

SJWC indicates in the Application that it wants to have the flexibility to issue whichever type of debt obligation is the cheapest, depending on its financial condition, capital requirements, and the then prevailing and anticipated market conditions. We place SJWC on notice that the reasonableness of the cost of money resulting from its issue of securities/indebtedness are subject to scrutiny in subsequent ratemaking proceedings and may result in disallowance, if determined imprudent.

Debt instruments are currently fashioned or marketed with thirty to fifty years maturity in today's capital markets. We will require SJWC to

stay within a 30-year term limit when issuing the debt or securities authorized in this decision.

4. Use of Proceeds

SJWC intends to apply the net proceeds from the proposed sale of Debt Securities: (i) to repay Applicant's \$20,200,000 outstanding short-term debt, (ii) reimburse Applicant's treasury for a portion of moneys actually expended prior to June 30, 2006 for capital improvements, (iii) finance a portion of the Applicant's capital expenditure program from 2007 through 2009, and/or (iv) for the acquisition of existing water systems.

a) Refinancing

SJWC presently has \$20,200,000 of outstanding short-term debt, which it anticipates paying off with part of the proceeds derived from the debt obligation requested in the Application.

Section 823 governs the regulation of the use of short-term debt. Section 823(d) provides that no note payable at a period of not more than twelve months after the date of issuance of such note shall, in whole or in part, be refunded by any issue of stocks or other evidence of interest or ownership, or of bonds, notes of any term or character, or any other evidence of indebtedness, without the consent of the Commission.

Based on the provision of § 823(d), a public utility may issue notes, for proper purposes and not in violation of any provision of law payable at periods of not more than twelve months after the date of issuance of the notes without the consent of the Commission, but no such note shall, in whole or in part, be refunded by any issue of stocks, notes of any term or character, or any other evidence of indebtedness without the consent of the Commission.

With the proposed liquidation or payment of short-term debt through the proceeds of the debt securities requested in this proceeding, it still remains the ultimate purpose of the Commission to see that the proceeds of security issues are spent for items which are properly chargeable to capital account.

Section 817 provides that a public utility may issue evidences of indebtedness payable at periods of more than 12 months only for specific purposes and no others. Among the authorized purposes are: i) for the construction, completion, extension, or improvement of its facilities, and ii) for the discharge or lawful refunding of its obligations.

Pursuant to § 817(d) and § 823(d), we will permit SJWC to pay off short-term debt with the financing authority granted in this decision, provided the short-term debt issues were used for operating expenses, items chargeable to capital account, and for the benefit of the public.

b) Treasury Reimbursement

As of June 30, 2006, SJWC has a total unreimbursed construction expenditure of \$152,386,573, as shown in Exhibit III, Schedule D of the Application. SJWC intends to use some of the proceeds from the subject debentures to reimburse its treasury for part of the cost expended for capital improvements from its treasury.

SJWC indicated that the unreimbursed construction expenditure was funded internally and not through debt financing, as supported by its Statement of unreimbursed Capital Construction Expenditure as of June 30, 2006. The reimbursement of construction expenditures using moneys expended from income of the public utility is one of the permitted uses of proceeds under § 817(h). Section 817(h) requires that the utility shows that i) the money so expended was not obtained from the issue of stock, bonds,

notes or other evidences of indebtedness, and ii) that the money was actually expended for one or more of the purposes mentioned in § 817.

While reimbursement of a utility's treasury for moneys spent in construction is a proper purpose for which Debentures may be issued, we will not make a finding in this decision on the reasonableness of SJWC's capital account. Capital expenditures and the resulting plant balances in rate base are issues that are normally addressed in general rate cases. Since SJWC incurred \$152,386,573 in construction expenses paid out from its treasury, and its reimbursement through the proceeds in this proceeding, this satisfies the requirement of § 817.

c) Construction Budget

SJWC's projected construction budgets for 2006 through 2009, as shown in Exhibit III, Schedule A, to the Application, are as follows:

<u>Components</u>	(Dollars in thousands)				<u>Total</u>
	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	
Land	5	5	5	5	20
Source of Supply	3,198	2,778	2,799	5,155	13,930
Water Treatment	991	32	1,065	10	2,098
Reservoirs & Tanks	1,647	4,019	3,022	2,578	11,266
Pump Stations & Equipment	4,115	3,579	2,692	3,062	13,448
Replacement Mains	18,438	21,503	25,005	27,789	92,735
New Mains	844	0	168	0	1,012
Distribution Mains	7,995	7,076	7,125	5,485	27,681
Equipment	996	2,087	3,621	1,396	8,100
Structures & Non-Specifics	<u>1,717</u>	<u>1,752</u>	<u>924</u>	<u>882</u>	<u>5,275</u>
Subtotal	39,946	42,831	46,426	46,362	175,565
Cost of Retiring	<u>1,123</u>	<u>1,168</u>	<u>1,215</u>	<u>1,082</u>	<u>4,588</u>
Total Capital Expenditures	<u>41,069</u>	<u>43,999</u>	<u>47,641</u>	<u>47,444</u>	<u>180,153</u>

SJWC intends to use part of the proceeds of the debt issue(s) for the construction of this new and replacement infrastructure. While the construction, extension or improvement of a company's facilities are proper uses for financing authority, pursuant to § 817(a), (b), (c) and (e), we will not make a finding in this decision on the reasonableness of SJWC's proposed construction program. Construction expenditures and the resulting plant balances for rate base are issues that are normally addressed in general rate cases.

d) Acquisitions

Requesting authority for the acquisition of a water system needs to be done by separate filing, and as applicable, in accordance with the requirements set forth in § 852 and § 2720 and Rules 1.5, 2.2, and 3.6 of the Commission's Rules of Practice and Procedure. While, § 817 (a) allows the use of proceeds of a debt issue to finance the acquisition of property, authorization by the Commission is required to purchase or acquire any other public utility, and any unauthorized agreement is void and of no effect. For SJWC to use the proceeds derived from this proceeding for acquisition of other water systems, it must first have valid authority from the Commission to purchase a specific water system(s).

5. Financial Information

a) Cash Requirements Forecast

SJWC's estimate of cash requirements for 2006 through 2009, as shown in Exhibit III, schedule C, to the Application are as follows:

(Dollars in Thousands)					
<u>Components</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>Total</u>
Construction Expenditures ³	41,069	43,999	47,638	47,444	180,150
Advances in Aid of Construction	8,000	8,000	8,000	8,000	32,000
Increase (Decrease) in Cash Reserve	<u>2,614</u>	<u>(10,881)</u>	<u>(692)</u>	<u>(731)</u>	<u>(9,690)</u>
Subtotal	51,683	41,118	54,946	54,713	170,492
Less:					
Estimated Cash Provided from Internal Sources	<u>24,314</u>	<u>34,319</u>	<u>48,008</u>	<u>19,109</u>	<u>125,750</u>
External funding required	27,369	6,799	6,938	35,604	44,742
% of Internally Available Cash to Needed Funds	47%	83%	87%	35%	74%

SJWC's projected cash requirements indicates that internally generated funds will provide approximately \$125,750,000 or 74% of its total cash requirements of \$170,492,000 for years 2006 through 2009. The requested debt authority would provide up to \$50,000,000 or 29% of the cash requirements for years 2006 through 2009. SJWC intends to obtain the remainder of \$23,000,000 or 13% from Advances for Construction (net of refunds). It appears that the financing authority sought is reasonably required to meet SJWC's cash requirement forecast.

³ Construction Expenditure estimates were taken from Exhibit III, Schedule A, in the application, which is also presented in SJWC's most recent General Rate Case (D.06-11-015) and is more detailed compared to estimates from Exhibit III, schedule C in the Application.

b) Capital Structure

SJWC's capital ratios as of June 30, 2006, are presented below as recorded and adjusted to give pro forma effect to the transactions listed below:

	(Dollars in thousands)				
	<u>Recorded</u>		<u>Adjustments</u>		<u>Proforma</u>
Long-term debt	131,927	42.62%	50,000	181,927	53.61%
Short-term debt	<u>20,200</u>	<u>6.53%</u>	<u>20,200</u>	<u>0</u>	<u>0.00%</u>
Total Debt	152,127	49.15%	70,200	181,927	53.61%
Preferred Stock	-	0.00%	-	-	0.00%
Common Equity	<u>157,436</u>	<u>50.85%</u>	<u>-</u>	<u>157,436</u>	<u>46.39%</u>
Total Equity	157,436	50.85%	0	157,436	46.39%
Total Capitalization	<u>309,563⁴</u>	<u>100.0%</u>	<u>70,200</u>	<u>339,363</u>	<u>100.0%</u>

Description of Adjustments:

A. Long-term Debt:

Issuance of \$50,000,000 of Debt Securities as requested in this Application.

B. Short-term Debt:

Payment of \$20,200,000 to retire of existing short-term debt.

C. Common Equity:

SJWC does not project any increases in retained earnings.

SJWC's authorized capital structure, as shown in D.04-08-054, dated August 19, 2004, consists of 52.42% common equity and 47.58% long-term debt. While it appears that approving SJWC's financing request will not materially change SJWC's capital structure to the detriment of ratepayers,

⁴ Mathematical errors contained in this table, as shown on page 3 of the application, were corrected by SJWC on October 20, 2006, by e-mail.

capital structures are normally subject to review in cost of capital or general rate case proceedings.

We put SJWC on notice that for purposes of ratemaking, we may impute a capital structure different from its actual capital structure in order to insure its rates are just and reasonable. We will not, therefore, make a finding in this decision of the reasonableness of the projected capital ratios for ratemaking purposes.

We remind SJWC that in exercising its authorized debt financings, including any existing authorizations, as well as the current debt authority, it shall endeavor to rebalance its capital structure to authorized levels to ensure that the resulting capital structure is in compliance with its most currently authorized capital structure.

6. Debt Approval

Pursuant to § 818, we will authorize SJWC's proposed issuance of Debt Securities in the aggregate principal amount of \$50,000,000, subject to the aforementioned conditions. Pursuant to § 851, we will allow SJWC to execute loan agreements and encumber its property whenever such encumbrance serves to secure the debt authorized herein.

Our authorization is not to be construed as a finding of the value of SJWC's stock or properties nor as indicative of the amounts to be included in proceedings for the determination of just and reasonable rates. Consistent with § 824, SJWC shall maintain records to (i) identify the specific long-term debt issued pursuant to this order, and (ii) demonstrate that the proceeds from such debt have been used only for the purposes authorized by this order.

We remind SJWC to observe the 30-year maturity limit for its Debt Securities issues.

7. Competitive Bidding Rule

The Competitive Bidding Rule set forth in Resolution (Res.) F-616, dated October 1, 1968, exempts debt issues of \$20,000,000 or less from the competitive bidding requirement. SJWC indicates in the Application that it will limit its debt offering to \$20,000,000 or less per issuance and/or no one purchaser will be permitted to acquire more than \$20,000,000 of debt securities in a calendar year.

In D.04-09-002, dated September 2, 2004, the Commission granted California Water Service Company an exemption from the Competitive Bidding Rule for a series of bond issuances of \$250 million, provided that no one series of bond issues would exceed \$20 million and/or no one purchaser would be able to acquire more than \$20 million of debt securities in a calendar year. In addition, the Commission found that in the event that the utility found it was necessary to go beyond the \$20 million thresholds, such offering of notes or bonds that exceeded \$20 million, up to \$200 million, must comply with the Competitive Bidding requirements of Res. F-616.

SJWC's exemption is similar to that authorized for California Water Service in D.04-09-002, and it appears that SJWC's request will comply with Res. F-616. Therefore, we will grant SJWC's request for exemption from the Competitive Bidding Rule for the previously described debt issues. Nevertheless, in the event that SJWC finds it necessary to go beyond either of the \$20,000,000 thresholds, such public offerings of debt in the principal amount that exceeds \$20 million, must comply with Res. F-616.

8. Notice

Notice of the filing of the Application appeared on the Commission's Daily Calendar of August 30, 2006.

9. Categorization and Need for Hearings

In Res. ALJ 176-3178, dated September 7, 2006, 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.

10. Comments on Proposed Decision

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

11. 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). SJWC should pay the fee of \$31,000.⁵

12. Assignment of Proceeding

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

Findings of Fact

1. A public hearing is not necessary.
2. SJWC, a California corporation, is a water utility subject to the jurisdiction of this Commission.
3. SJWC project the need for external funds for the purposes set forth in the Application.
4. Presently, debt instruments are fashioned or marketed with thirty years maturity in the capital markets.

⁵ The fee is determined as follows: $(\$2 \times (1,000,000/1,000)) + (\$1 \times 9,000,000/1,000) + (\$0.50 \times 40,000,000/1,000) = \$31,000$.

5. Res. No. F-616 specifically exempts debt issues of \$20,000,000 or less from the Competitive Bidding Rule.

6. The reasonableness of any resulting construction expenditures, cash requirements forecast, capital structure, interest rate and cost of money arising from debt capital is subject to review in cost of capital or general rate case proceedings.

7. Section 818 requires Commission authorization for the issue of stocks, bonds, notes, or other evidences of indebtedness payable at periods of more than 12 months.

8. Section 852 requires Commission authorization for a public utility to purchase or acquire another public utility.

9. The authorization granted herein is not a finding of the value of SJWC's stock or property, nor does it indicate approval of matters subject to review in cost of capital or ratemaking proceedings.

10. Notice of the filing of the Application appeared on the Commission's Daily Calendar of August 30, 2006. There is no known opposition to this Application, and the authority requested should be granted.

Conclusions of Law

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

2. Authorizing SJWC to offer, issue and deliver: 1) debt securities (Debentures) consisting of: a) senior notes, with or without insurance, b) medium term notes, c) project specific financing, or d) first mortgage bonds and/or 2) debt securities relating to participation in governmental or agency tax free debt financing, with interest rates based on existing

market conditions at the time of negotiating the terms as set forth in the Application would not be adverse to the public interest.

3. SJWC should be exempt from the Competitive Bidding Rule so long as each issuance does not exceed \$20,000,000 and no once purchaser acquires more than \$20,000,000 of debt securities in any calendar year.

4. The financing authority sought in this application is reasonably required for the purposes specified.

5. SJWC should pay the fee determined in accordance with §1904(b).

6. 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, San Jose Water Company (SJWC), upon terms and conditions consistent with those set forth or contemplated in Application 06-08-025 (Application), with the conditions specified below, is authorized to:

- a) Issue, sell, and deliver New Securities not exceeding \$50,000,000 in aggregate principal offering amount, said securities consisting of Senior Notes, Medium Term Notes, Project Specific Financing, First Mortgage Bonds, and Debt Securities relating to participation in governmental or agency tax free debt financing.
- b) Execute and deliver any and all related documents required for the completion of the proposed financing, including, without limitation, an indenture or supplemental indenture; and
- c) Encumber its assets in connection with the debt issue in accordance with both existing and new mortgage Bond requirements.

2. SJWC shall apply the proceeds of the New Securities authorized for the purposes specified in their Application and discussed in this decision.

3. Debt Securities shall be marketed with a maximum of fifty years maturity.

4. SJWC shall obtain all necessary regulatory authorizations for any acquisitions of water systems and such authorizations are not given here.

5. SJWC's proposed issuance and sale of debt securities are exempt from the requirements of the Commission's Competitive Bidding Rule so long as each issuance does not exceed \$20,000,000 and no one purchaser acquires more than \$20,000,000 of debt securities in any calendar year. All other issues of debt securities, other than tax-exempt securities, are subject to the Competitive Bidding Rule, addressed in Resolution F-616, dated October 1, 1968.

6. SJWC shall maintain records to (i) identify the specific long-term debt issued pursuant to this order, and (ii) demonstrate that the proceeds from such debt have been used only for the purposes authorized by this order.

7. SJWC shall keep and maintain copies of the agreements for the sale of the New Securities, and within thirty days from request provide copies to the Water Division's Utility Audit, Finance and Compliance Branch (UAFCB).

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

9. The authority granted by the order shall become effective when SJWC pays \$31,000 as required by Public Utilities Code § 1904(b).

10. The Application is granted as set forth above.

11. Application 06-08-025 is closed.

This order is effective today.

Dated January 11, 2007, at San Francisco, California.

MICHAEL R. PEEVEY
President
DIAN M. GRUENEICH
JOHN A. BOHN
RACHELLE B. CHONG
Commissioners