Decision 08-09-030 September 18, 2008

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of PARK WATER COMPANY (314W) for authority to issue evidence of indebtedness (First Mortgage Bonds).	Application 08-07-003 (Filed July 3, 2008)

DECISION AUTHORIZING PARK WATER COMPANY TO ISSUE UP TO $20 MILLION OF FIRST MORTGAGE BONDS

1. Summary

This decision grants Park Water Company (Park) authority to issue up to $20 million of First Mortgage Bonds, as requested in Application (A.) 08-07-003. It also requires Park to make a showing of reasonableness for ratemaking purposes of the capital structure and cost of debt resulting from the transactions approved by this decision, including early retirement of debt and prepayment penalties, as part of its scheduled May 1, 2009 Class A Water Company Cost of Capital Application.

Park shall also continue to adhere to the conditions pertaining to affiliate transactions enumerated in Decision (D.) 04-06-018 and Section 8 of D.06-01-019. Park may report on a quarterly basis all the information required by General Order 24-B with respect to debt issued pursuant to this decision. The authority granted by this decision does not become effective until Park remits $3,000 to the Commission's Fiscal Office.

2. Background

Park, a California corporation, is a Class A water utility under the jurisdiction of this Commission. Park provides water service in the southeastern and northeastern sections of Los Angeles County through its Central Basin Division. Park has a wholly-owned public utility subsidiary in California, Apple Valley Ranchos Water Company, which operates a public utility water system in and near the Town of Apple Valley in San Bernardino County. Park also has a wholly-owned public utility subsidiary in Montana, Mountain Water Company, which provides water service within and around the community of Missoula, Montana. Mountain Water Company is a regulated utility under the jurisdiction of the Montana Public Service Commission. Park's principal office and place of business is located at 9750 Washburn Road, Downey, CA.

3. Request

Park seeks authorization to issue up to $20 million of new First Mortgage Bonds, retire $18 million of existing bonds, and reimburse its treasury in the amount of $2 million for funds expended on capital improvements. This application was supplemented by an August 14, 2008 response to requests by the assigned Administrative Law Judge (ALJ). This supplemental response was placed in the formal file as Item # 1t, a copy of which was provided to protestant Division of Ratepayer Advocates (DRA).

Park's request to issue New First Mortgage Bonds is subject to §§ 816, *et seq*. of the Public Utilities Code.[1] The Commission has broad discretion under §§ 816, *et seq.* to determine if a utility should be authorized to issue debt. Where

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

necessary and appropriate, the Commission may attach conditions to the issuance of debt to protect and promote the public interest.

3.1. Source of Financing

Park engaged Banc of America Securities LLC (BAS) to act as its financial advisor and Agent to negotiate an extension and/or to refinance $8 million in bonds held by OneAmerica (formerly known as American United) having a 8.18% interest rate with a 2014 maturity date and $10 million in bonds held by Nationwide Life having a 7.32% interest rate, also with a 2014 maturity date.[2]

BAS successfully negotiated an extension of the 8.18% notes with OneAmerica as to terms, provisions, pricing, with an increase in the principal amount of bonds to $10 million from $8 million. However, BAS was unable to negotiate an extension of the 7.32% bonds with Nationwide. Instead, BAS obtained a commitment from Pacific Life to purchase $10 million in bonds.

These new bonds would be issued as First Mortgage Bonds in conformity with provisions of, and secured by, Park's Trust Indenture, dated November 1, 1973, between Park and certain Trustees, as supplemented, amended and restated by the Eight Supplemental Indentures, dated February 1, 2002. Park anticipates that the form of the new First Mortgage Bonds would be similar to the form of bonds included in its Tenth Supplemental Indentures, dated January 27, 2006, filed as Exhibit C to the application. These new bonds will be identified as the Eleventh and Twelfth Supplemental Indentures of its Trust Indenture.

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[2] The Commission's competitive bidding rule is not applicable in this instance because new debt issues of $20 million or less are exempted from the competitive bidding rule. (Resolution F-616, dated October 1, 1986.)

3.1.1. OneAmerica Bonds

The OneAmerica bonds are to have a final maturity date 25 years from their issuance date with an average life of 22 years. These bonds will carry a 7.46% interest rate, based on a 275 basis point spread above the June 20, 2008 actual 30-year Treasury rate of 4.71%. However, the 7.46% interest rate would increase 10 basis points to 7.56% if the closing dates on these bonds occur after August 19, 2008.[3] OneAmerican's commitment to purchase the $10 million in bonds expires if the transaction has not closed by November 1, 2008, within 120 days after July 4, 2008.

3.1.2. Pacific Life Bonds

The Pacific Life bonds are to all mature 30 years after their issuance date and carry a 7.65% interest rate, based on a 300 basis point spread above the 30-year Treasury rate set on June 12, 2008. Park subsequently clarified in a data response to the ALJ that the 7.65% interest rate was actually based on a 300 basis point spread above the 30-year treasury rate of 4.65% set on June 6, 2008, not the 4.77% 30-year Treasury rate set on June 12, 2008. Pacific Life's commitment to

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[3] This negotiated 7.46% bond interest rate is not attainable given that the first scheduled Commission meeting date the Commission could consider approval of the application without waiving statutory rules and established procedures was August 21, 2008, two days after the entire transaction had to be closed. This is because: (1) Park did not file its application until July 3, 2008; (2) notice of the application appeared on the July 10, 2008 Commission Daily Calendar; (3) the protest period did not end until August 11, 2008; and (4) the next scheduled Commission meeting that the Commission could consider approving the application was August 21, 2008, assuming that: (a) no protests were received; (b) a draft decision could be prepared and complete draft review within one day; and (c) the Commission delayed a scheduled August 11, 2008 Agenda mailing date.

purchase the $10 million in bonds expires if the transaction has not been funded by December 31, 2008.

3.2. Use of Proceeds

A majority of the proceeds from the issuance of new bonds would be used to retire $8 million of bonds held by OneAmerica and $10 million held by Nationwide Life. The use of bond proceeds for the retirement of, or in exchange for, outstanding bonds is an allowable use of bond proceeds, as set forth in § 817(g).

Park will deposit the remaining $2 million of new bond proceeds into its treasury to reimburse its treasury for funds used for capital improvements in 1999. Park used approximately $3 million of its treasury funds in 1999 to fund capital projects undertaken by its California corporate office, Central Basin Division, subsidiary Apple Valley Ranchos Water and Montana subsidiary, Mountain Water. Of this amount, approximately $1 million was used for capital improvements in Park's California operations and $2 million in its Montana operations.

Reimbursement of treasury funds expended for capital improvements is an allowable use of bond proceeds, as set forth in § 817(h).

3.3. Reason for Financing

Park seeks authority to issue new bonds on the basis that it has a "limited window of opportunity" to refinance its long-term debt before the principal payments on those bonds are due. Park defined that window of opportunity to be between 2008 and 2011 when principal payments on the bonds scheduled to be retired begins. Principal payments of $2.5 million per year begins in 2011 and ends in 2014 for the $10 million bonds held by Nationwide Life and $2.66 million per year beginning in 2012 and ending in 2014 for the $8 million in bonds held by

OneAmerica. Absent such refinancing, Park would need to divert cash earmarked for capital expenditures to pay the principal on the bonds scheduled to be retired.

This diversion of cash would have a significant detrimental effect upon Park's and its subsidiaries' ability to construct and replace necessary infrastructure because the combined annual principal payments on the bonds, once they become due, would require $5.16 million in annual principal bond payments. That amount is over half of the actual 2007 and forecasted annual $10 million capital budget through 2014 for Park and its subsidiaries combined. With an annual availability of approximately $6.4 million cash from depreciation expense and $3 million from earnings, Park's internally generated funds fall short of meeting its annual capital requirements by approximately $1 million without even considering the $5.16 million in principal payments.

4. Discussion

Park borrows funds required by the operations of its Central Basin Division and its subsidiaries and transfers capital as needed to its division and subsidiaries through intercompany transactions. As such, the Commission has recognized a single consolidated capital structure for all of Park and its subsidiaries for ratemaking purposes. The Commission also requires Park to adhere to the conditions pertaining to affiliate transactions enumerated in D.04-06-018 and Section 8 of D.06-01-019. The Montana Public Service Commission also recognizes a single consolidated capital structure for Mountain Water Company under its jurisdiction.

Park has substantiated that it will need $20 million in new First Mortgage Bonds to satisfy its future needs for retiring long-term debt and financing capital expenditures. This purpose is authorized by § 817, and, as required by § 818, the related expenditures are not reasonably chargeable to operating expenses or income. In addition, approval of this application will not result in a material change in Park's overall capital structure. Park's 2008 actual long-term debt ratio of 46.7% is expected to increase to 47.6%; its actual common equity ratio of 53.3% would decrease to 52.4%. Therefore, we may grant Park authority under § 816 *et seq.* to issue up to $20 million of long-term debt for the aforementioned purpose, as detailed in the application.

4.1. Concern

However, we are concerned with Park's proposal of retiring bonds that are not due to mature until 2014, at the beginning of its 2008 through 2011 "window of opportunity," particularly since Park will incur approximately $2.3 million in early prepayment penalties, 12% of the $18 million principal bonds to be retired or 13% of the $20 million principal bonds to be issued. Park anticipates that it will amortize its prepayment penalties over the remaining life of the bonds being retired as accepted by the Commission for rate setting in D.06-08-015. Park also anticipates that with the $2 million reimbursement into its treasury for previous capital expenditures, it will have adequate monies in its treasury to cover the prepayment penalties. Although we are not considering or approving any rate making methods in this proceeding, we observe that D.06-08-015 was the result of a settlement agreement, which is not precedent setting.

Park explains that any deferral of its refinancing would result in a higher effective cost of debt than refinancing now. This is because, although the prepayment penalties would be reduced, an increase in interest rates forecast for a 2011 refinancing, prior to when principal payments are due, would more than offset the effect of the lower prepayment penalties. A Park comparison of the overall effective debt costs resulting from these two scenarios shows that the overall effective debt cost resulting from refinancing now is 8.3245% compared to an overall effective debt cost resulting from 2011 refinancing of 8.5451%, over 22 basis points higher.

We are also concerned with Park seeking authority to issue new bonds based on a predetermined interest rate based on a June 6, 2008 prior period 30-year treasury rate of 4.65% for the new Pacific Life bonds, and on a June 20, 2008 prior period of 4.71% for the new OneAmerica bonds with an assumption that interest rates will increase substantially during Park's window of opportunity to refinance its old bonds. While we do not forecast interest rates, we observe that the 30-year treasury rate has been decreasing since the benchmark 30-year Treasury rates were set for the new bonds, an indication that interest rates will not substantially increase during Park's window of opportunity to refinance its bonds. In this regard we take official notice of the August 1, 2008 30-year treasury rate of 4.57% and the September 2, 2008 rate of 4.36%, both of which are lower than the benchmark 30-year Treasury rates used for the new negotiated bonds. Park should reassess and document the reasonableness of its negotiated terms for new bonds prior to closing the agreements and provide that documentation as part of its May 1, 2009 scheduled Class A Water Company Cost of Capital Application.

Park recognized in its application that authorization to retire existing bonds and to issue new bonds does not constitute a finding of reasonableness of the resultant capital structure and cost of debt for ratemaking purposes. Park also recognized in its application that the Commission's practice is not to make such findings in its decision on financing applications. Park proposes to include a showing on the reasonableness for ratemaking purposes of the capital structure and cost of debt resulting from these transactions in its May 1, 2009 scheduled Class A Water Company Cost of Capital Proceeding.

4.2. Conclusion

We find that the proposed financing is for allowable purposes, as set forth by § 817. However, we make no finding regarding the reasonableness of the rates, terms, and conditions of debt issued by Park. We will review the reasonableness of the interest rate and associated fees as part of Park's scheduled May 1, 2009 Class A Water Company Cost of Capital application.

Consistent with § 824, Park 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 today's decision.

5. Reporting Requirement

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.[4] Park should be treated no differently. Park 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 theretofore been paid to the Commission. (§ 1904.1.)

Of the $20 million of requested long-term debt, $18 million will be used to retire and replace existing long-term debt for which the fee was previously paid to the Commission. Hence, only the $2 million of the proposed financing proceeds is subject to a fee. If Park actually uses any of the $18 million designated 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 Securities report after issuance how it used the $18 million of long-term debt earmarked to replace existing long-term debt.

Park shall remit the required $3,000 fee to the Commission's Fiscal Office.[5] The authority granted by this decision shall not become effective until Park remits the $3,000 fee to the Commission's Fiscal Office.

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[4] *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.

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.[6] 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.

Park expects that it will use the entire $2 million of the $20 million proposed financing proceeds to reimburse Park for money it has previously expended for capital improvement and $18 million to retire and replace currently issued and outstanding bonds. This decision does not authorize any capital expenditures. To the extent capital expenditures are financed with the proceeds of the bonds issued pursuant to this decision, CEQA review should occur as needed through the regulatory processes applicable to each capital project.

8. Category and Need for Hearings

Park requested that this matter be categorized as ratesetting. By Resolution ALJ 176-3217, dated July 10, 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 July 10, 2008.

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[5] The fee is assessed on $2 million of authorized Long-Term New First Mortgage Bonds as follows: ($2 times ($1,000,000/$1,000) plus ($1 times $1,000,000/$1,000) equals $3,000.

[6] Public Resources Code Section 21080.

The DRA filed a limited protest of this application on August 11, 2008. DRA, recognizing that Park has a limited opportunity to pursue refinancing, did not oppose approval of the application. However, consistent with Park's proposal, DRA recommended that a review of the prudency of the bonds to be issued by Park should be undertaken as part of Park's scheduled May 2009 Cost of Capital Application. Hence, there is no opposition to the approval of this application. Based on the record, we affirm that this is a ratesetting proceeding, and that a hearing is not necessary.

9. Waiver of Comment Period

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

10. Assignment of Proceeding

Timothy Alan Simon is the assigned Commissioner and Michael J. Galvin is the assigned ALJ in this proceeding.

Findings of Fact

1. Park is a public utility subject to the jurisdiction of this Commission.

2. Park seeks authority to issue up to $20 million of new First Mortgage Bonds.

3. Park seeks to retire $8 million of bonds held by OneAmerica and $10 million of bonds held by Nationwide Life.

4. Park has a reasonable need to issue $20 million on new First Mortgage Bonds in the near future.

5. DRA filed a limited protest requesting that a prudency review of the bonds to be issued by Park should be undertaken as part of Park's scheduled May 2008

Cost of Capital Application. However, DRA did not oppose approval of this application.

6. Official notice is taken of the 30-year Treasury rates at August 1,2008 and September 2, 2008.

7. Park requested as part of its application that a prudency review of the bonds to be issued be undertaken as part of its scheduled May 2008 Cost of Capital Application.

8. Resolution F-616 automatically exempts new bond issues from the Commission's competitive bidding rule if the total amount of new debt financing is $20 million or less.

9. 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.

10. A.08-07-003 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.08-07-003 appeared in the Commission's Daily Calendar.

12. In Resolution ALJ 176-3217, the Commission preliminarily determined that this proceeding should be categorized as ratesetting and those hearings would not be necessary.

Conclusions of Law

1. This is a ratesetting proceeding.

2. There is no need for hearings.

3. The proposed issue of bonds is for lawful purposes and the money to be obtained is required for these purposes.

4. Park is authorized to execute and deliver the Eleventh and Twelfth Supplemental Indentures relating to the authorized debt issues.

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

6. A showing of reasonableness for ratemaking purposes of the capital structure and cost of debt resulting from the transactions, including early retirement of debt and prepayment penalties, should be undertaken in Park's May 1, 2009 scheduled Class A Water Company Cost of Capital Application.

7. Park should continue to adhere to the conditions pertaining to affiliate transactions enumerated in D.04-06-018 and Section 8 of D.06-01-019.

8. The application should be granted as requested.

9. The authority granted by this decision should not become effective until Park has paid the fees prescribed by § 1904 (b).

10. The following order should be effective immediately so that Park may issue as soon as needed the debt authorized herein.

O R D E R

IT IS ORDERED that:

1. Park Water Company (Park) is authorized to issue $20 million of new long-term debt to retire and replace existing long-term debt and to reimburse its treasury for monies expended for capital improvements.

2. Park shall make a showing of reasonableness for ratemaking purposes of the capital structure and cost of debt resulting from the transactions, including

early retirement of debt and prepayment penalties, as part of its May 1, 2009 scheduled Class A Water Company Cost of Capital Application.

3. Park shall continue to adhere to the conditions pertaining to affiliate transactions enumerated in D.04-06-018 and Section 8 of D.06-01-019.

4. Park may report on a quarterly basis all the information required by General Order 24-B with respect to debt issued pursuant to this decision. Park shall report this information on a monthly basis if directed to do so by Commission staff.

5. Park 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.

6. Park shall remit to the Commission's Fiscal Office a check for $3,000 as required by § 1904(b) of the Public Utilities Code. The decision number of this decision shall appear on the face of the check.

7. The authority granted by this decision shall not become effective until Park remits $3,000 to the Commission's Fiscal Office.

8. Application 08-07-003 is closed.

This decision is effective today.

Dated September 18, 2008, at San Francisco, California.

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