

CACD/RAX

Decision 92-01-026 January 10, 1992

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the matter of the Application
of Suburban Water Systems (U339-W)
for an order (a) authorizing it to
issue and sell not exceeding
\$8,000,000 principal amount of its
First Mortgage Bonds, Series B, and
(b) authorizing it to execute and
deliver a Second Amendment and
Supplement to its existing Indenture
of Mortgage and Deed of Trust

ORIGINAL

Application 91-11-028
(Filed November 7, 1991)

O P I N I O N

Summary of Decision

This decision grants Suburban Water System's (Suburban) request for authority to issue and sell not exceeding \$8,000,000 aggregate principal amount of its 9.09% First Mortgage Bonds, Series B, (Debt Securities) as described in Application 91-11-028 (Application). As part of this Application, Suburban also requests the authority to execute and deliver a Second Amendment and Supplement (Second Supplement) to the Indenture of Mortgage and Deed of Trust dated October 1, 1986, (Indenture) to the Security Pacific National Bank as Trustee. This authority is granted under Public Utilities (PU) Code §§ 816 through 851.

Notice of the filing of the Application appeared on the Commission's Daily Calendar of November 25, 1991. No protests have been received.

Partial Denial of Application

Suburban's request to amortize the costs of issuance of the Debt Securities over a period of thirty years is denied. The Commission Advisory and Compliance Division (CACD) recommends that the issuance costs be tested in the utility's cost of capital proceeding and not be treated as an operating expense. The

Commission has considered CACD's recommendation and, finding it reasonable, will adopt it as stated above.

Further, Suburban's proposal in the Application, to use a portion of the funds for repayment of its refund contracts, is denied. Water utilities are allowed to recoup these costs from their customers through depreciation expense. CACD notes that it is not the Commission's policy to allow the utilities to use funds obtained from long-term debt for items which are compensated as operating expenses. We concur with CACD's recommendation.

Background

Suburban, a California corporation, operates as a public water utility subject to the jurisdiction of this Commission. Suburban provides water service to customers in portions of Los Angeles and Orange counties.

For the twelve-month period ended October 31, 1991, Suburban reported that it generated total operating revenues of \$21,191,866, and net income of \$2,515,097 as shown in supplemental data to the Application supplied to CACD.

Also shown in the supplemental data is Suburban's Unconsolidated Balance Sheet at October 31, 1991, summarized as follows:

<u>Assets</u>	<u>Amount</u>
Net Utility Plant	\$46,931,005
Current Assets	3,426,647
Other Assets/Deferred Charges	<u>2,751,957</u>
Total	\$53,109,609
 <u>Liabilities and Equity</u>	
Common Stock Equity	\$17,468,048
Cumulative Preferred Stock	3,982,267
Long-Term Debt	13,200,000
Current Liabilities	4,707,524
Total Other Liabilities and Deferred Credits	<u>13,751,770</u>
Total	\$53,109,609

Debt Financing

Suburban requests authority to issue and sell not exceeding \$8,000,000 principal amount of its 9.09% First Mortgage Bonds, Series B. The Debt Securities are to be issued in accordance with, secured by, and have terms and conditions as set forth in, the Indenture, as amended and supplemented. The Second Supplement, which will be executed and delivered simultaneously with the issuance of the Debt Securities, will set forth, among other things, the aggregate principal amount, interest rate and maturity date of the series of Debt Securities.

Suburban has not, at the present time, entered into any contract for the purchase and sale of the Debt Securities. Suburban plans to place the Debt Securities privately with an accredited institutional investor.

Description of the Financing and Manner of Issuance

Suburban proposes to sell up to \$8,000,000 aggregate principal amount of its Debt Securities for cash at 100% of the principal amount thereof plus accrued interest. The Debt Securities are to mature in thirty years.

Suburban proposes that the terms and conditions of the Debt Securities will provide for an interest rate of 9.09 percent and a make-whole optional redemption price equal to the greater of (i) par or (ii) the present value of all remaining interest and principal payments, with such present value to be determined using a discount rate equal to the yield on U.S. Treasury securities having a maturity date corresponding with the average life of the Debt Securities being prepaid plus 0.5 percent.

Suburban requests that the costs of issuance of the Debt Securities be amortized over a period of thirty years. Issuance costs are normally included in the embedded cost of debt calculation in the cost of capital determination and are not treated as an operating expense. Therefore, CACD recommends that Suburban's request to expense the issuance costs over thirty years be denied. The Commission concurs and will adopt CACD's recommendation. Further, Suburban is placed on notice by this decision that the Commission does not find that the issuance costs are necessary or reasonable for ratemaking purposes. These are issues normally tested in general rate case or cost of capital proceedings.

Exemption from Competitive Bidding

Suburban notes in its Application that the issuance and sale of the Bonds is exempt from the Commission's Competitive Bidding Rule set forth in Decision (D.) 38614, as amended by D.49941, D.75556, and D.81903, and by Resolution Numbers F-591 and F-616. CACD has reviewed Suburban's request and has determined that since the principal amount of the Debt Securities is less than \$20,000,000, the exemption is warranted. CACD recommends that Suburban's request be granted. We concur with CACD's recommendation.

Construction Budgets

Suburban's estimated construction budget, as summarized and included in Exhibit B to the Application, is shown below. Suburban estimates that expenditures required for this construction program for 1991 through 1993 will approximate \$8,302,000.

	<u>1991</u>	<u>1992</u>	<u>1993</u>
	(Thousands of Dollars)		
Bartolo Project	\$1,000	\$1,380	\$ 250
Other construction projects*	<u>1,434</u>	<u>2,445</u>	<u>1,793</u>
Total	\$2,434	\$3,825	\$2,043

* Includes completions, extensions and improvements

CACD has reviewed Suburban's Application and construction budget. CACD concludes that the proposed financing is necessary for Suburban's construction program. CACD has no objection to Suburban's proposed issuance and sale of its Debt Securities as requested in the Application; however, Suburban is placed on notice by this decision that the Commission does not find that its construction program is necessary or reasonable for ratemaking purposes. These are issues normally tested in general rate case or rate base offset proceedings.

Capitalization Ratios

Suburban's capitalization ratios as of October 31, 1991, and after giving pro forma effect to the proposed financing, are as follows:

<u>Component</u>	<u>October 31, 1991</u>	<u>Pro Forma</u>
Long-Term Debt	38.1%	48.6%
Preferred Stock	11.5%	9.5%
Common Stock and Retained Earnings	<u>50.4%</u>	<u>41.9%</u>
Total	100.0%	100.0%

These capitalization ratios give pro forma effect to the proposed sale of up to \$8,000,000 aggregate principal amount of the Debt Securities and retirement of \$900,000 of Series A Bonds through Suburban's October 1, 1992, sinking fund payment.

Suburban is placed on notice by this decision that the Commission does not find that Suburban's capital ratios are necessary or reasonable for ratemaking purposes. Those are issues normally tested in general rate case or cost of capital proceedings.

Cash Requirements Forecasts

Suburban's cash requirements, included as part of the supplemental data supplied to CACD, are shown as follows:

<u>Components</u>	<u>1991</u>	<u>1992</u>	<u>1993</u>
	(Thousands of Dollars)		
Funds Needed for Capital Additions	\$ 3,253	\$ 3,825	\$ 2,043
Long-Term Debt Maturities	900	900	900
Increase (Decrease) in Cash Reserve	(395)	4,483	(1,830)
Less: Estimated Cash from Internal Sources	<u>2,558</u>	<u>4,008</u>	<u>213</u>
Additional Funds Required from Outside Sources	\$ 1,200	\$ 5,200	\$ 900

CACD has analyzed Suburban's cash requirements forecasts for 1991 and 1992, and has concluded that internally generated funds will only provide 68.1% or \$2,558,000 of Suburban's cash requirements for 1991, 43.5% or \$4,008,000 for 1992, and 19.1% or 213,000 for 1993. CACD therefore concludes that the proposed borrowing by Suburban is necessary to help meet forecasted cash requirements which include capital expenditures.

CACD has reviewed the Application and has concluded that the proposed financing is reasonable and that the authority should be granted. The Commission has considered CACD's recommendations, and finding them reasonable, will adopt them as stated above.

Use of Proceeds

In its Application, Suburban proposes to use the net proceeds for the sale of the Debt Securities for the following purposes: (1) redemption and retirement, through annual sinking fund payments of \$900,000, of portions of Suburban's Series A Bonds issued under the Indenture; (2) construction, completion, extension and improvement of Suburban's facilities; and (3) repayment of refund contracts.

CACD has reviewed the uses requested by Suburban and recommends that the uses related to sinking fund payments and construction expenditures are for proper purposes. However, CACD does not recommend that Suburban be allowed to use a portion of the funds obtained from the Debt Securities for repayment of its refund contracts. Water utilities typically receive advances from developers to construct main extensions to a development in order for the developer to obtain water. Each year the utility is required to make a percentage refund back to the developer to pay off these advances. At the same time, the utility is allowed to recoup the payment of the advances through depreciation expense from its customers. It is not the Commission's policy to allow the utility to use long-term debt for items which are compensated as

directly or indirectly related to operating expenses. The Commission has considered CACD's recommendations, and finding them reasonable, will adopt them as stated above.

Findings of Fact

1. Suburban, a California corporation, operates as a public water utility subject to the jurisdiction of this Commission.
2. Suburban needs external funds for the purposes set forth in the Application.
3. The proposed issuance and sale of the Debt Securities, as outlined in this decision, are for proper purposes and are not adverse to the public interest, with the exception of the proposed use of the funds to refund its contract repayments.
4. The proposed Second Supplement is not adverse to the public interest.
5. The proposed Debt Securities are exempt from the Commission's Competitive Bidding Rule under Commission Resolution No. F-616.
6. The proposed redemption provisions pertaining to the Debt Securities are reasonable.
7. The money, property, or labor to be procured or paid for by the proposed financing is reasonable and required for the purposes specified in the Application.
8. The Commission does not, by this decision, determine that Suburban's construction program is necessary or reasonable for ratemaking purposes. These issues are normally tested in general rate case or rate base offset proceedings.
9. The Commission does not, by this decision, determine that Suburban's capital ratios and debt costs are necessary or reasonable for ratemaking purposes. These issues are normally tested in general rate case or cost of capital proceedings.

10. Suburban may not, for ratemaking purposes, amortize the debt issuance costs over a period of thirty years as an operating expense.

11. There is no known opposition to the Application and no reason to delay granting the authority requested.

12. Suburban has paid the fee set by PU Code § 1904(b).

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 security issue and related agreements are for lawful purposes and the money, property or labor to be obtained by them is required for these purposes. Proceeds from the financing may not be charged to operating expenses or income, not for the refunding of contract repayments.

4. The following order should be effective on the date of signature to enable Suburban to proceed expeditiously with its financing.

ORDER

IT IS ORDERED that:

1. Suburban Water Systems (Suburban), on or after the effective date of this order and before December 31, 1992, is authorized to issue and sell up to \$8,000,000 aggregate principal amount of its First Mortgage Bonds, Series B (Debt Securities).

2. Suburban may execute any and all related documents required for completion of the proposed financing.

3. Suburban shall apply the net proceeds from the sale of the Debt Securities to the purposes set forth in this decision.

4. Suburban shall not, for ratemaking purposes, amortize the debt issuance costs over a period of thirty years as an operating expense.

5. The Debt Securities are exempt from the Commission's Competitive Bidding Rule set forth in Resolution F-616, dated October 1, 1986.

6. Suburban shall submit copies of the Second Amendment and Supplement to the Indenture of Mortgage and Deed of Trust to the Commission Advisory and Compliance Division (CACD) within fifteen days after execution.

7. Suburban shall submit copies of the contract for the sale of the Debt Securities to CACD within fifteen days of the execution of the contract.

8. Suburban shall file the reports required by General Order Series 24.

9. The Application is granted as set forth above.

10. Suburban shall submit an original and four copies of the reports required by ordering paragraphs six through eight to CACD with a transmittal letter stating the application and decision numbers. Parties need not be served with copies of the reports

unless they contact Suburban in writing to request such service. When service is made on parties who request copies of the reports, Suburban shall attach to its report a certificate showing service by mail upon all those requesting copies. The Director of CACD shall send the original and one copy of each report to the Docket Office for filing.

The authority granted by this order to issue Series B Bonds will be effective today as Suburban has previously paid \$9,000.00, the fee set by Public Utilities Code § 1904(b). In all other respects, this Order is effective today.

Dated January 10, 1991, at San Francisco, California.

Daniel Wm. Fessler
President

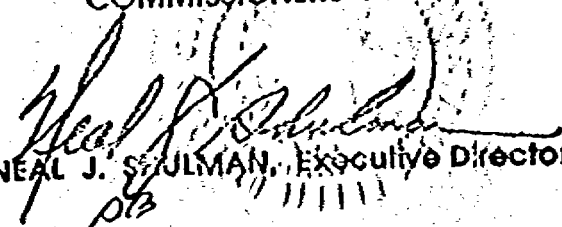
John B. Ohanian

Patricia M. Eckert

Norman D. Shumway

Commissioners

I CERTIFY THAT THIS DECISION
WAS APPROVED BY THE ABOVE
COMMISSIONERS TODAY


NEAL J. SULMAN, Executive Director