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Decision 83 06 085 JUN 29 1983

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of CALIFORNIA WATER SERVICE COMPANY, a corporation, for an order (a) authorizing it to issue and sell not exceeding $35,000,000 principal amount of its First Mortgage Bonds, Series AA, (b) exempting the issuance and sale of said Series AA Bonds from the competitive bidding rule set forth in Decision No. 38614, as amended, and (c) authorizing it to execute and deliver a Supplemental Mortgage of Chattels and Trust Indenture.	Application 83-04-08 (Filed April 5, 1983)

OPINION

California Water Service Company (Cal Water) requests authority, under Public Utilities (PU) Code Sections 818 and 851, for the following:

1. To issue and sell, up to $35,000,000 aggregate principal amount of its First Mortgage Bonds, (New Bonds), Series AA, by means of a negotiated private placement; a negotiated public offering; or by competitive bidding under terms and conditions to be determined by market conditions which will govern the price, interest rate, maturity date, and redemption provisions of the New Bonds at the time of sale;

2. To be exempted from the Commission's competitive bidding requirements those New Bonds sold through negotiated public offering or negotiated private placement;

3. To shortened to one day the period of time between the public invitation for bids and the opening of bids for Cal Water's New Bonds sold through competitive bidding, and

4. To execute and deliver a Supplemental Mortgage of Chattels and Trust Indenture.

Summary of Decision

This decision grants Cal Water the authority requested in its application.

Notice of the filing of the application appeared on the Commission's Daily Calendar of April 7, 1983. No protests have been received.

Cal Water, a California corporation, opereates as a public utility under the jurisdiction of this Commission. Cal Water engages in the sale and distribution of water services in many localities in California from Chico to the Palos Verdes Peninsula.

For calendar year 1982, Cal Water reports it generated operating revenues of $71,529,445 and net income of $7,791,586 as shown in its Statement of Income and Earned Surplus attached to the application as part of Exhibit A.

Also shown as part of Exhibit A is Cal Water's Balance Sheet as of December 31, 1982 summarized as follows:

Assets	Amount
Net Utility Plant	$203,418,253
Other Physical Property-Net	218,825
Current Assets	8,840,300
Deferred Charges	905,800
Total	$213,383,178
Liabilities and Equity	
Common Equity	$ 67,624,755
Preferred Stock	6,466,775
Long-Term Debt	79,732,700
Current Liabilities	13,281,714
Advances and Contributions in Aid of Construction	45,234,235
Deferred Credits and Reserves	1,042,999
Total	$213,383,178

Cal Water proposes to issue and sell up to $35,000,000 aggregate principal amount of its New Bonds by means of a negotiated private placement, a negotiated public offering, or by competitive bidding under terms and conditions to be determined by market conditions, prevailing immediately prior to the time of sale, which will govern the price, interest rate, maturity date, sinking fund provisions, redemption price, and call protection for the New Bonds. Cal Water will advise the Commission by letter, promptly after the sale of the New Bonds, of the terms and conditions of the sale. The New Bonds will be dated May 1, 1983 and will mature on a date not later than November 1, 2023 as Cal Water may determine.

Cal Water proposes to issue and secure the New Bonds in conformity with the provisions of an existing Indenture dated April 1, 1928 as supplemented, amended, and modified by thirty indentures supplemented thereto which will be further supplemented by its proposed Thirty-Second Supplemental Mortgage of Chattels and Trust Indenture (Supplemental Indenture). This Supplemental Indenture will be similar in form to past indentures between Cal Water and the American Trust Company (now the Wells Fargo Bank, National Association) and the Los Angeles - First National Trust & Savings Bank (now the Security Pacific National Bank), Trustees.

Cal Water intends to negotiate the sale either privately with institutional purchasers to arrange a private sale or with a group of underwriters for a negotiated public offering; however, it does not wish to be precluded from selling the New Bonds by means of competitive bidding if this proves to be in the best interests of the company and its ratepayers.

Cal Water has not yet determined whether it will be able to obtain terms more favorable to it through issuance and sale of its New Bonds at a private sale to institutional investors, through a negotiated underwriting, or through competitive bids, and seeks authorization from the Commission to follow any of those procedures. Exhibit F to the application shows that for the period June 1982 to March 1983 interest rates of public debt offerings at times have been below private offerings while at times the reverse has been true. Cal Water advises that the expenses of a private sale are usually lower than those relating to a public offering.

Cal Water reports it had unreimbursed capital expenditures totaling $52,507,763 as of December 31, 1982 as shown in Exhibit C attached to the application as amended by letter dated May 31, 1983. Excluding projects to be financed by advances for construction and contributions in aid of construction, the utility estimates gross construction outlays for 1983 will amount to $10,754,000 of which 75% will be financed with internally generated funds. Estimated gross construction expenditures for calendar year 1983 are detailed below from Exhibit B attached to the application as follows:

Purpose	Amount
Land and Land Rights	$ 85,000
Structures and Improvements	770,000
Wells	87,000
Storage	360,000
Pumping Equipment	860,000
Water Treatment Equipment	20,000
Transmission and Distribution Mains	5,191,000
Services	1,296,000
Meters	824,000
Hydrants	266,000
General Equipment	995,000
Total	$10,754,000

The Commission's Revenue Requirements Division has reviewed Cal Water's application and its 1983 construction budget. The Division has no objection to the proposed sale of Cal Water's security issue but reserves the right to reconsider the reasonableness of any specific construction expenditure in future rate proceedings.

Request for Exemption from Competitive Bidding

Cal Water requests an order from the Commission exempting the New Bonds from the Commission's competitive bidding rule established by Decision (D.) 38614 dated January 15, 1946 in Case 4761 as amended by D.49941, D.75556, and D.81908. These decisions contemplate that under appropriate circumstances the Commission will not require competitive bidding. Cal Water believes that the reasons set forth in a letter dated May 13, 1983 from its attorney are compelling and justify the issuance by the Commission of an order granting this exemption. The reasons for requesting an exemption are shown below:

"1. The most common argument put forth in favor of competitive bidding is that it assures the lowest possible cost of money to the issuer because of the selection of the highest of two or more competitive bids. However, there is no clear evidence that either competitive bidding or negotiated sales consistently result in a lower cost of money for the issuer.

2. Competitive bidding is most successful when the following circumstances are present:

   a. The capital markets are stable;

   b. There is a light financing calendar;

2. (Continued)

   c. The issuer is a large, highly-rated, well known company;

   d. The issue is of sufficient size to attract a number of bidders;

   e. There are no unusual aspects to the offering; and

   f. There are no significant changes (or prospects of change) in a company's operating or financial condition which should be communicated to potential purchasers of its securities.

The capital markets today are far from stable. Uncertainties about the Federal Government's deficit, the Federal Reserve's monetary policy, the international banking system, and the general economy have all created a very erratic market. It is not uncommon for long-term interest rates to move 25 basis points or more in a single day. Competitive bidding does not afford an issuer the flexibility necessary to take advantage of these interest rate fluctuations. Further, although Cal Water is a large water company, it is only a fraction of the size of the typical electric or gas utility which issues its securities through competitive bids. The size of the proposed Series AA offering represents 44% of Cal Water's presently outstanding debt and the success of the sale will have an immense impact on Cal Water's financial stability. However, the size of the offering is only minimal in relation to typical competitive offerings of the energy utilities.

3. Cal Water has had only one public bond offering in the past 35 years, the Series T Bonds which were sold in 1975 and are to be refunded by the Series AA Bonds. All other debt financing by Cal Water has been through private placements of $6 million or less. Cal Water does not expect to make any further new offerings of substantial size in the foreseeable future. Therefore, its securities are unlikely to attract the necessary interest for a successful competitive offering. In addition, since the majority of Cal Water's securities, both stock and bonds, are held by Californians, there is little national interest in Cal Water's securities.

4. While it is not possible to state categorically that either negotiated or competitive underwriting discounts are consistently lower over a substantial period of time, a number of important factors favoring negotiated sales should be considered. They are as follows:

   a. A negotiated sale affords an issuer greater flexibility in a number of critical areas. One of the most important of these is the opportunity to compare interest rates in the public and private markets and to gain access to these alternative markets rapidly. This flexibility can provide significant cost savings to an issuer since interest rates in the public and private markets do not always move in tandem, and hence may alternately provide the most favorable rates depending on external market factors.

4.a. (Continued)

Flexibility is also afforded in the opportunity to accelerate or postpone an offering date so as to take advantage of changing market conditions. The ability to take advantage of temporary improvements in the fixed income markets can be an important determinant in the cost of money to an issuer. A negotiated sale provides the opportunity for greater feed-back from the marketplace and thus permits the issuer to adjust terms of the security, (such as the non-refundable period, call premium, and maturity date) to meet the changing needs of the marketplace.

b. A negotiated sale of securities involves a close relationship between the issuer and the investment banker. In today's complex financial markets, the assistance of an investment banker in designing the terms of securities to best fit the needs of the issuer and the marketplace is increasingly important. This assistance would not be available in the event of a competitive offering and Cal Water, not having had a competitive offering in the past 35 years, is totally lacking in the experience necessary to make such an offering.

4. (Continued)

   c. In a negotiated sale, the investment banker's continuing sense of obligation to the issuer, as well as competitive pressures, provide strong motivations for the manager to do the best possible job of pricing the securities for the client. This sense of obligation to the issuer is clearly absent in a competitive offering.

5. In the case of a negotiated public offering, the following additional considerations also apply:

   a. A negotiated sale results in a better distribution of the securities because the underwriting syndicate is stronger. The syndicate is comprised of those underwriters most capable of doing an effective job of distributing the particular securities being sold. In competitive bidding, the syndicate's strength is diluted since the best underwriters and distributors are likely to be split among several competing groups.

   b. In a negotiated sale, the underwriters and their salesmen know well in advance that they will definitely have the securities to sell, and thus have more incentive to contact prospective purchasers in advance of the actual offering. This circumstance stimulates greater presale interest in the offering, results in better placement of the securities, and may provide more accurate inputs to the pricing decision. These factors can be especially important to relatively small and infrequent issuers such as

5.b. (Continued)

Cal Water which require a concentrated sales effort to attract sufficient investor interest. Without this sales effort, small issues which are competitively bid are often neglected by many underwriters, especially when the financing calendar is crowded with larger issues which are easier to sell, a condition which often coincides with the most attractive market conditions.

The factors discussed in the preceding subparagraphs (a) and (b) reduce the level of risk and uncertainty in an offering, particularly in times of volatile markets. In competitive bids, such risk and uncertainty can result in excessive safety margins being built into the submitted bids. To the extent that an extensive sales effort reduces the risk in an offering, benefits can accrue to the issuer in the form of a lower cost of funds.

6. By reason of the factors set forth above, the sale of Cal Water's Series AA Bonds through a negotiated public or private offering will enable it to obtain money at a cost at least as low as, if not lower than, the cost obtainable if the Series AA Bonds were sold through competitive bids. Accordingly, it is in the public interest that the Commission exempt the proposed issuance of the Series AA Bonds from competitive bidding requirements."

In D.91984 dated July 2, 1980 (San Diego Gas & Electric Company) in Application (A.) 59633, we discussed the granting of exemptions from the competitive bidding rule and we clarified the nature of the compelling showing that must be made to warrant an exemption from the rule. We served notice that assertions regarding the volatility of the market; the flexibility provided by a negotiated sale; and the importance of maximizing the effectiveness of the underwriting will not serve as compelling reasons, individually or collectively, for granting an exemption from the competitive bidding rule.

The Commission's Revenue Requirements Division believes that the principles of the competitive bidding rule are valid under current economic conditions; however, because Cal Water seldom issues its bonds in a public offering and is not well known in investment circles, the Division recommends that an exemption from the competitive bidding rule be granted at this time to provide Cal Water with the greater financial flexibility in marketing its New Bonds. Cal Water should also be granted, in the alternative, the authority to issue the proposed New Bonds by means of competitive bidding.

We are frankly uncertain whether strict adherence to the competitive bidding rule would prove beneficial in this instance. Consequently, for this application only, we will accept the recommendation of the Revenue Requirements Division. We will authorize Cal Water to proceed on either a competitive bid, a private placement, or a negotiated public offering.

If Cal Water chooses to issue and sell its proposed New Bonds by means of a negotiated public offering or by a private placement, we place Cal Water on notice that in its next general rate proceeding before the Commission, the reasonableness of the resulting interest rate and cost of money to the company will be closely scrutinized and may result in a disallowance of the interest expense if it is determined that the cost of money incurred was not the most prudent. We will also require Cal Water to provide us with a showing of why it believes the resulting interest rate and cost of money were the most advantageous to the company and its ratepayers. We will require this showing within a reasonable period of time after the issuance and sale of the proposed New Bonds.

Cal Water requests, in the event conditions in the financial markets warrant the issuance and sale of its New Bonds by competitive bidding, that the period of time, required by the competitive bidding rule for notification of an invitation for bids, be reduced from five days to one day. This reduced time interval is required because decisions relative to the method by which a financing takes place in today's volatile financial markets must be made as close as possible to the date of sale.

Use of Proceeds

Cal Water proposes to use the gross proceeds from the sale of the New Bonds as follows:

1. To defray the expense of the issuance and sale of the New Bonds;
2. To refund at maturity, on November 1, 1983 or call at par prior to this date, its 8-3/4% First Mortgage Bonds, Series T, in the aggregate principal amount of $25,045,000 and
3. To reimburse Cal Water's treasury for a portion of moneys actually expended prior to December 31, 1982 for capital improvements.

In a letter dated May 31, 1983, the company makes the following statements:

> "...., when the Company applied for authorization to issue first mortgage bonds not to exceed $35,000,000 it had not determined nor has it yet so determined the exact amount of financing to be required. However, the Company has since agreed to purchase the assets of Westlake Water Company for a cash cost of approximately $2,500,000. If this purchase is consummated the funds would be derived from the $35,000,000 first mortgage bond issue now before the Commission."

Cal Water's capital ratios as of December 31, 1982 are shown below as recorded and adjusted to give pro forma effect to the transactions that follow:

	December 31, 1983	Pro Forma
Long-Term Debt	51.8%	54.8%
Preferred Stock	4.2	3.9
Common Equity	44.0	41.3
Total	100.0%	100.0%

1. The proposed issuance and sale of First Mortgage Bonds, Series AA, in the aggregate principal amount of $35,000,000 and

2. The retirement on November 1, 1983 of 8-3/4% First Mortgage Bonds, Series T, in the aggregate principal amount of $25,045,000 (D.84401 dated May 6, 1975 in A.55560).

Cal Water states in its application that as of December 31, 1982 it had $4,000,000 in short-term loans outstanding and asserts these loans were obtained for the purpose of assisting to defray the cost of its 1982 construction program. Cal Water believes it will be necessary for it to make further short-term borrowings prior to the sale of its New Bonds and that it can repay these funds from the proceeds received from the sale.

The Commission's Revenue Requirements Division has reviewed the application and has analyzed Cal Water's cash requirements forecast provided the Commission in supplemental data and has concluded internally generated funds will provide about 75% of capital expenditures in 1983. The Division has concluded that the proposed sale of Cal Water's New Bonds is necessary to help meet forecasted cash requirements and recommends the company be granted the authority to issue and deliver its Thirty-Second Supplemental Indenture.

We accept the recommendation of the Revenue Requirements Division and authorize Cal Water to execute and deliver its Supplemental Indenture in a form consistent with prior supplemental indentures filed with this Commission.

Findings of Fact

1. Cal Water, a California corporation, operates as a public utility under the jurisdiction of this Commission.

2. The proposed sale of Cal Water's New Bonds would be for proper purposes.

3. Cal Water has need for external funds for the purposes set forth in the application.

4. The money, property, or labor to be procured or paid for by the proposed New Bonds is reasonably required for the purposes specified in the application.

5. The sale of the proposed New Bonds should not be required to be through competitive bidding.

6. The proposed supplemental indenture would not be adverse to the public interest.

7. Shortening the period between the public invitation for bids and the opening of bids for those New Bonds sold by competitive bidding from five days to one day would not be adverse to the public interest.

8. There is no known opposition to the application and no reason to delay granting the authority requested.

Conclusions of Law

1. A public hearing is not necessary.

2. The application should be granted to the extent set forth in the order which follows.

The proposed New Bonds are for lawful purposes and the money, property, or labor to be obtained by them are required for these purposes. Proceeds from the security issue may not be charged to operating expenses or income.

The following order should be effective on the date of signature and payment of the fee set by PU Code Section 1904(b) to enable Cal Water to proceed with the sale of its New Bonds expeditiously.

O R D E R

IT IS ORDERED that:

1. California Water Service Company (Cal Water), on or after the effective date of this order and on or before December 31, 1983 may issue and sell its First Mortgage Bonds (New Bonds), Series AA, in an aggregate principal amount up to $35,000,000 hereby exempted from the Commission's competitive bidding rule and in accordance with the terms and conditions to be negotiated as described in the application. These New Bonds may be sold by means of a negotiated private placement; a negotiated public offering; or through competitive bidding.

2. Cal Water's proposed New Bonds are exempted from the Commission's competitive bidding requirements.

3. Cal Water may shorten the period of time between the public invitation for bids and the opening of bids for the proposed New Bonds from five days to one day for those sold through competitive bidding.

4. Cal Water may execute and deliver its Thirty-Second Supplemental Indenture in substantially the same form as the previous supplement indentures filed with the Commission and may incorporate all terms consistent with this opinion.

5. Within 30 days after the issuance and sale of the New Bonds sold by means of negotiated public offering or private placement, Cal Water shall file a written report with the Commission, showing the name of the purchaser, the price, the interest rate, the cost of money to Cal Water based on the price and interest rate, and other provisions or terms that it deems relevant.

6. If the New Bonds are sold on a private placement basis or by a negotiated public offering, within 30 days after their issuance and sale, Cal Water shall file, with the Commission, a report setting forth the reason that it believes the resulting interest rate and cost of money, to the company, were the most advantageous to the company and its ratepayers.

7. As soon as available, Cal Water shall file, with the Commission, three copies of its final prospectus (if any) pertaining to the New Bonds sold by public offerings.

8. Cal Water shall apply the proceeds from the sale of the New Bonds for the purposes referred to in the application.

9. Cal Water shall file the reports required by General Order Series 24.

10. The authority granted by this order to issue New Bonds will be effective when Cal Water pays $10,955, the fee set by PU Code Section 1904(b) after taking credit for the retirement of its First Mortgage Bonds, Series T, in the amount of $25,045,000. In all other respects this order is effective today.

Dated JUN 29 1983, at San Francisco, California.

LEONARD M. GRIMES, JR.
President
VICTOR CALVO
PRISCILLA C. GREW
DONALD VIAL
WILLIAM T. BAGLEY
Commissioners

PUBLIC UTILITIES COMMISSION
STATE OF CALIFORNIA
PAID
$10,955.00
JUL 1 1983
G-9288
By

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

Joseph E. Bodovitz, Executive Director