

Decision 93589 October 6, 1981

ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application)
of LAGUNA HILLS WATER COMPANY,)
for authority to incur a long-)
term indebtedness of \$500,000.)

Application 60490
(Filed April 29, 1981;
amended June 4, 1981)

In the Matter of the Application)
of LAGUNA HILLS WATER COMPANY,)
for authority to issue 5,000)
shares of its common stock.)

Application 60491
(Filed April 29, 1981;
amended June 4, 1981) ✓

O P I N I O N

By these applications, Laguna Hills Water Company (LHWC) seeks authority to obtain \$1 million in additional debt and equity capital.

By Application (A.) 60490, LHWC seeks authority to secure a \$500,000 loan, to issue a covering note, and to encumber its property to secure the loan. The purpose of the loan is to provide funds to repurchase LHWC's main extension contracts (MECs). By A.60491, LHWC seeks authority to issue 5,000 shares of its \$100 par value common stock to Laguna Hills Utility Company, its parent company, for \$500,000 in cash. The purpose of the stock issuance is to raise funds to pay amounts overdue on MECs.

LHWC proposes to borrow the \$500,000 from United California Bank (UCB) for a period of approximately 3½ years at a variable interest rate which will be set approximately at 1% or 2% over the prime rate. LHWC will refinance the unpaid balance in 1984 when it will refinance its Series A first mortgage bonds.

The note covering the loan will be secured by a first mortgage on LHWC's facilities if the holder of LHWC's existing first mortgage bonds consents to a partitioning of the existing first mortgage. If consent is not obtained, the note will be secured by an assignment to UCB of all MECs repurchased with the loan proceeds. Those MECs would be conditionally terminated during the life of the loan. In the event of default, all repayment amounts accrued on those MECs would be immediately due and payable to UCB, and UCB would be entitled to future payments in accordance with LHWC's then authorized repayment policy.

LHWC's outstanding MEC contract balance (exclusive of presently due or overdue amounts) is approximately \$2,999,000. LHWC will purchase as many of its MECs as possible with the proceeds of the loan from UCB. At an 18% discount rate, such repurchase would reduce LHWC's outstanding contract balances by approximately 41% (i.e., LHWC estimates that \$1,234,000 in MEC balances will be repurchased with the proceeds of the loan).

On December 31, 1980 LHWC was \$512,000 in arrears in its MEC repayment obligations. Any sums additional to the proceeds from the stock issue required to completely repay the overdue amounts will be provided through internally generated funds.

These two financing applications are important components of an indicated solution to the critical financial problems confronting this utility. As discussed at length in our decision on certain applications in the A.58440 and related applications proceeding, also being issued today, the indicated solution encompasses:

1. Stabilizing future in-tract main extension refunds on currently outstanding contracts by basing refunds on constant rate levels for water service;
2. Stretching out the period for refunds on special facilities which have recently come on line, or which are about to come on line, to make the timetable for these refunds more manageable; and
3. Providing for more adequate capitalization through authorizing LHWC's proposals to obtain \$1 million in additional debt and equity financing.

In that decision we held that approval of the \$500,000 stock issue was essential to a prompt repayment of LHWC's overdue MEC payment obligations, a resolution of pending formal complaints, and a reduction in LHWC's working capital deficiency by \$500,000. Similarly, it was held that the repurchase of MECs as proposed in A.60490 will substantially reduce the ratio of advances for construction to debt and equity capital and will yield a greater than 2 for 1 reduction in future liabilities, as represented by advances for construction, for each dollar expended on repurchasing MECs, thereby providing a needed strengthening of LHWC's financial position.

In addition, from LHWC's A.60635 filed June 8, 1981 seeking rate relief, we noted in the aforesaid decision that the proposed repurchase of MECs would increase rate base by \$500,000 and gross revenues by less than 3% as a first-year effect, that the crossover point would be reached in about 7 years, and that thereafter rate base and thus revenue requirements would become progressively less with the buyback than otherwise for the remaining life of the plant involved.

Findings of Fact

1. A.60490 and A.60491 are important components of an overall solution to the critical financial problems confronting this utility, as set forth in a decision also being issued today in A.58440 et al.

2. In A.60490 LHWC proposes to borrow \$500,000 from UCB for 3½ years at a variable interest rate which will be set at about 1% over the prime rate. The loan will be used to repurchase LHWC's MECs from present holders.

3. The repurchase price of the MECs on an average will approximate 40% of the contract balance, if an interest rate of 18% is used to determine the price.

4. The repurchase of the MECs will materially reduce LHWC's advances for construction, a primary source of its financial difficulties. Relatedly, it will improve LHWC's balance sheet by substantially reducing the ratio of advances for construction to debt and equity capital.

5. The rate effect of the repurchase of the MECs on gross revenues is less than 3% at its peak, which occurs in the first year, and after about 7 years the rate effect will be to progressively reduce the revenue requirements over that which would otherwise be required.

6. The buyback of the MECs will strengthen this utility and, on balance, this is in the ratepayers' interest.

7. In A.60491 LHWC proposes to issue 5,000 shares of its \$100 par value common stock. The proceeds from the stock will be used to pay amounts overdue to holders of LHWC MECs.

8. Approval of this proposed stock issue is essential to a prompt repayment of LHWC's overdue MEC refunds, a resolution of pending formal complaints, and a reduction in LHWC's working capital deficiency by \$500,000.

9. The proposed security issues are for lawful purposes. The money, property, or labor to be obtained from the issues are required for these purposes, which are not, in whole or in part, chargeable to operating expenses or income.

Conclusions of Law

1. A.60490 and A.60491 should be granted.

2. In light of the record in A.58440 and related matters and the decision issued today in that proceeding, a public hearing in A.60490 and A.60491 is not necessary.

The number of shares outstanding, the total par value of the shares, and the dividends paid do not determine allowable return on plant investment. This authorization is not a finding of the value of the utility's stock or property, nor does it indicate the amounts to be included in ratesetting proceedings.

O R D E R

IT IS ORDERED that:

1. Laguna Hills Water Company (LHWC), on or after the effective date of this order and on or before December 31, 1981, may:
 - a. Incur a long-term indebtedness of \$500,000, issue evidence of such indebtedness, and encumber its property, all substantially in the manner and for the purpose set forth in Application (A.) 60490; and
 - b. Issue 5,000 shares of its \$100 par value stock to Laguna Hills Utility Company for \$500,000 in cash for the purpose set forth in A.60491.

2. LHWC shall file the reports required by General Order Series 24.

The authority granted by this order to issue an evidence of indebtedness and to execute and deliver an encumbering document will become effective when the issuer pays \$1,000, set by PU Code Section 1904(b). The authority granted by this order to issue stock will become effective when the issuer pays \$1,000, set by PU Code Section 1904.1. In all other respects this order is effective today.

Dated October 6, 1981, at San Francisco, California.

JOHN E. BRYSON

President

RICHARD D. GRAVELLE

LEONARD M. GRIMES, JR.

VICTOR CALVO

PRISCILLA C. GREW

Commissioners

I certify that this decision was approved by the above Commissioners today.

