

Decision 96-10-062 October 25, 1996

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of)
CALIFORNIA WATER SERVICE COMPANY)
U-60-W, for Authorization to (1) issue)
and/or sell on or before December 31,)
1999 not exceeding in aggregate amount)
\$115,000,000 of any combination of)
(a) shares of its common stock,)
(b) shares of its preferred stock,)
(c) debt securities consisting of any)
combination of (i) senior notes,)
(ii) medium term notes, (iii) project)
specific financing, (iv) monthly)
income preferred securities (MIPS) or)
(v) first mortgage bonds, and/or)
(d) debt securities relating to)
participation in governmental or)
agency tax free debt financing and)
(2) exempting the issuance and sale of)
said debt from the competitive bidding)
rule set forth in Decision No. 38614,)
as amended.)

ORIGINAL

Application 96-08-035
(Filed August 13, 1996)

O P I N I O N

Summary of Decision

This Decision grants the authority requested by California Water Service Company (CWS) in Application 96-08-035 (Application).

CWS requests authority, pursuant to §§ 816 through 830 and 851 of the Public Utilities (PU) Code for the following:

1. To issue and sell on or before December 31, 1999, in aggregate amount not exceeding \$115,000,000 any combination of (a) shares of its common stock, (b) shares of its preferred stock, (c) debt securities in the form of (i) senior notes, (ii) medium term notes, (iii) project specific financing, (iv) MIPS or (v) first mortgage bonds and/or (d) debt securities relating to participation in governmental or agency tax free debt financing for the purposes set forth in the Application;

2. To obtain an exemption from the Commission's Competitive Bidding Rule for the issuance of debt securities;
3. To use the net proceeds from the proposed financing in accordance with the provision of PU Code § 817, specifically for capital expenditure, acquisition of property, and redemption of long-term debt.

Notice of the filing of the Application appeared on the Commission's Daily Calendar of August 20, 1996. No protests have been received.

Background

CWS, a California corporation, operates as a public utility subject to the jurisdiction of this Commission. CWS provides water service to customers in many localities in the State of California from Chico in the north to the Palos Verdes Peninsula in the south.

For the twelve months ended May 31, 1996, CWS reported that it generated operating revenues of \$172,430,866 and net income of \$16,184,685, as shown in Exhibit A to the Application.

CWS' Balance Sheet as of May 31, 1996, shown as part of Exhibit A, is summarized as follows:

<u>Assets</u>	<u>Amount</u>
Net Utility Plant	\$432,138,492
Investment in Non-Utility Property	515,965
Current Assets	28,614,468
Other Assets	<u>\$ 29,498,446</u>
Total Assets	\$490,767,371
 <u>Capitalization and Liabilities</u>	 <u>Amount</u>
Common Shareholders' Equity	\$145,866,280
Preferred Stock	3,475,000
Long-Term Debt	145,540,000
Current Liabilities	31,574,582
Unamortized Investment Tax Credit	3,178,581
Deferred Income Taxes	14,100,179
Regulatory Liabilities	11,466,682
Advances for Construction	95,176,368
Contributions in Aid of Construction	<u>40,389,699</u>
Total Capitalization and Liabilities	\$490,767,371

Proposed Securities

CWS proposes to issue equity securities in the form of shares of its common stock and preferred stock. CWS states in the Application that it may issue and sell shares at private or public offering or on a negotiated basis through one or more underwriters. In a public offering the underwriter would agree to purchase shares pursuant to an underwriting agreement to be entered into by CWS and the representatives of the underwriters with the intention that said underwriters will then offer the shares to the public.

CWS further states that it has not entered into any underwriting agreement and does not anticipate doing so until the timing of the issuance of the shares is determined. The final terms of the underwriting agreement and other terms, as applicable, of the proposed offering, including the price of the shares, the exact number of shares to be offered, and the underwriting spread with respect thereto, will be determined by negotiation between CWS and the underwriter shortly before any proposed offering. No offering of rights to shareholders is contemplated.

As an alternative to obtaining equity securities, CWS proposes to enter into MIPS transactions. Under a MIPS financing arrangement, a form of preferred security is issued and sold privately or publicly through either a limited liability company, a limited partnership or a business trust (special purpose entity). The special purpose entity would be a subsidiary or other affiliate of CWS and would issue securities and commit the proceeds from the issuance to CWS. Such loan arrangement would be evidenced by deferrable interest subordinated debentures to be issued by CWS.

MIPS have certain characteristics of preferred stock and therefore receive equity credit from the major rating agencies comparable to that of preferred stock. In addition MIPS have a significant tax advantage since CWS' capital costs are comprised of interest, not dividends, and would therefore be tax deductible.

CWS also proposes to issue in one or more series, any combination of debt securities at private sale or through negotiated underwritings. CWS states in the Application that the precise amount and timing of each financing, the market in and method by which it is effected, price and interest rate and other

material provisions (including, without limitation, maturity, sinking fund, redemption price, call protection) of the debt securities issued in each financing will be determined by CWS, with due regard for its financial condition and requirements and the prevailing and anticipated market conditions.

We will authorize CWS's proposed issue of equity and debt securities in the aggregate principal amount not exceeding \$115,000,000. We place CWS on notice that the reasonableness of any resulting interest rate and cost of money arising from debt capital are normally subject to review in cost of capital or general rate case proceedings.

We will require CWS to maintain, and, within thirty days from request, provide the Water Division or Finance Branch any or all of the following:

1. The price, interest rate and other terms pertaining to its issuance of debt securities.
2. Copies of the purchase and underwriting agreements and the final prospectus pertaining to stock offering.
3. Copies of the indentures and supplemental indentures setting forth, among other things, the aggregate principal amount, interest rate, conversion factors, redemption and sinking fund requirements and the maturity date of issues of bonds and debentures.
4. Copies of the agreements setting forth, among other things, the aggregate principal amount, interest rate, final maturity date and other items of any series of notes.

We will also grant CWS' request to issue MIPS. This Commission has granted similar authorization under PU Code § 701.5 for deferrable interest securities (which include MIPS) to Pacific Gas and Electric Company, San Diego Gas & Electric Company, and Southern California Edison Company.

Pursuant to PU Code § 701.5(c), we will approve CWS' request to guarantee or otherwise secure, through one or more

agreements to such effect, deferrable interest securities issued by one or more special purpose entities.

CWS' special purpose entity should be created solely for the purpose of issuing securities to the public to support CWS' operations or service. CWS shall have 100% ownership and control of the special purpose entity. In addition, the activities of the special purpose entity will be subject to federal or state securities regulation and to the regulation of this Commission through its oversight of CWS' financing activities.

We remind CWS that it will be expected to demonstrate and support in a future proceeding that the specific capital costs incurred were appropriate and beneficial under the circumstances. Furthermore, we will limit ratepayers' responsibility for expenses that may arise from interest on taxes that may be assessed by the Internal Revenue Service (IRS) if expected tax advantages do not materialize (back taxes), as well as any penalties or interest on penalties. Ratepayers will be responsible for (1) back taxes, to the extent that benefits of reduced taxes were flowed through to them, and (2) interest on ratepayer-recovered back taxes, calculated at no more than the rate earned on prime, three-month commercial paper, as reported in the Federal Reserve Statistical Release, G-13.

The Commission reserves the right to make a full assessment and measurement of deferrable interest securities at a future date.

Competitive Bidding Rule

The Competitive Bidding Rule set forth in Resolution (Res.) F-616 dated October 1, 1968, exempts bond issues of \$20,000,000 or less from the competitive bidding requirement. CWS indicates in the Application that it will not issue any one series of debt in excess of \$20,000,000 and will not sell more than \$20,000,000 in total during any calendar year to any one purchaser. Accordingly, CWS believes that its proposed issuance and sale are exempt from the requirements of the Competitive Bidding Rule. We concur.

Construction Budget

CWS' estimated construction expenditures for 1996 through 1999, as shown in Exhibit D to the Application, are as follows:

<u>Components</u>	<u>Estimated 1996-1999</u>
Land & land rights	1,173,241
Structures & improvements	6,180,575
Wells	1,279,034
Storage	4,077,264
Pumping & water treatment equipment	8,797,805
Transmission & distribution mains	33,120,494
Services	10,847,966
Meters	12,187,667
Hydrants	4,591,184
General equipment	8,244,770
Total	90,500,000

We will not make a finding in this decision on the reasonableness of CWS' proposed construction program. Construction expenditures and the resulting plant balances in rate base are issues which are normally addressed in general rate cases.

Capital Ratios

CWS' capital ratios as of March 31, 1996 are shown below as recorded and as adjusted to give pro forma effect to the transactions that follow:

	<u>Recorded</u>		<u>Pro Forma</u>	
	<u>(\$000)</u>	<u>%</u>	<u>(\$000)</u>	<u>%</u>
Common Stock Equity	145,191	49.4	202,691	49.5
Preferred Stock	3,475	1.2	3,475	0.8
First Mortgage Bonds	125,540	42.7	125,540	30.8
Senior Notes	20,000	6.8	77,500	18.9
Total Capitalization	294,206	100.0	409,206	100.0

1. Projected issuance of \$57,500,000 debt securities.
2. Projected issuance of Common Stock with an estimated proceeds of \$57,500,000.

Capital structures are normally subject to review in cost of capital or general rate case proceedings. We will not, therefore, make a finding in this decision of the reasonableness of the projected capital ratios for ratemaking purposes.

Cash Requirements Forecast

CWS' estimate of cash requirements for 1996 through 1999 is summarized as follows:

<u>Components</u>	(\$000)			
	<u>1996</u>	<u>1997</u>	<u>1998</u>	<u>1999</u>
Construction Expenditures	21,500	22,000	22,000	25,000
Long-Term Debt:				
Sinking Fund Retirement-Variou	632	608	620	2,240
Maturity of Series K & L	2,565	2,139	0	0
Calling & Refunding of Debt	<u>20,000</u>	<u>10,000</u>	<u>0</u>	<u>0</u>
Sub-Total	23,197	12,747	620	2,240
Total Cash Requirements	44,697	34,747	22,620	27,240
Less: Beginning Short-Term				
Investment Balance	4,500	0	0	0
Estimated Cash Available				
from Internal Sources	<u>(5,100)</u>	<u>14,158</u>	<u>(3,278)</u>	<u>3,272</u>
Additional New Funds Required				
from Outside Sources	45,297	20,589	25,898	23,968

CWS' estimated cash requirements indicate that it would require additional funds from external financing sources amounting to \$115,752,000 for 1996 through 1999.

Use of Proceeds

CWS intends to apply the net proceeds from the proposed debt capital financings and equity offerings for such purposes as may be allowed under PU Code § 817. As stated on page 5 of the Application, these purposes include without limitation construction, completion, replacement, extension or improvements of its facilities; acquisition of property and water systems; retirement of long-term debt; satisfying first mortgage bonds sinking fund requirements; paying off outstanding short-term debt;

and reimbursement of moneys previously expended from income for which its treasury has not been reimbursed.

PU Code § 823(d) provides:

No note payable at a period of not more than 12 months after the date of issuance of such note shall, in whole or in part, be refunded by any issue of stocks or stock certificates 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.

Finance Branch advises us that CWS' proposed use of proceeds is for proper purposes and is not adverse to the public interest. For purposes of this Application and pursuant to PU Code §§ 818 and 823(d), we will approve CWS' intended use of proceeds (including retirement and discharge of short-term debt) from the proposed issue of equity and debt securities .

CWS is placed on notice by this decision that the proceeds from the financing transaction cannot be charged to operating expenses or income.

Findings of Fact

1. CWS, a California corporation, is a public utility subject to the jurisdiction of this Commission.
2. CWS needs external funds for the purposes set forth in the Application.
3. The proposed issuance of debt securities and equity capital is for proper purposes and is not adverse to the public interest.
4. Authorizing CWS to determine the amount, timing, terms and conditions, and method of offering its proposed financing would not be adverse to the public interest.
5. CWS' proposal to enter into MIPS transactions with a special purpose entity and to unconditionally guarantee or otherwise secure the entity's payment obligations would be for proper purposes and could offer financial advantages to CWS and its ratepayers.

6. Savings resulting from the difference in costs between raising capital through a MIPS transaction and a traditional preferred stock issuance will be passed to ratepayers in the annual revisions of CWS' authorized cost of capital.

7. For MIPS transactions, ratepayers should not be responsible for penalties or interest on penalties, if any. Ratepayers will be responsible for any back taxes to the extent that benefits of reduced taxes were previously flowed through to them. Ratepayers will also be responsible for interest on ratepayer recovered back taxes, calculated at the prime, three-month commercial paper rate, as reported in the Federal Reserve Statistical Release, G-13.

8. The special purpose entity would be under CWS' ownership and control and would engage only in activities in support of CWS' regulated operations.

9. CWS will not issue any one series of debt in excess of \$20,000,000 and will not sell more than \$20,000,000 in total during any calendar year to any one purchaser.

10. The Commission does not by this decision determine that CWS' construction budget, capital ratios, and cash requirements forecast are necessary or reasonable for ratemaking purposes. These issues are normally tested in general rate case proceedings.

11. The reasonableness of any resulting interest rate and cost of money arising from debt and equity capital are normally subject to review in cost of capital or general rate case proceedings.

12. PU Code § 823(d) provides that no note payable at a period of not more than 12 months after the date of issuance of such note shall be refunded, in whole or in part, by any issue of stocks or stock certificates 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.

13. There is no known opposition to the Application and there is 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.
3. The Competitive Bidding Rule does not apply to CWS' proposed issuance and sale because CWS will not issue any one series of debt in excess of \$20,000,000 and will not sell more than \$20,000,000 in total during any calendar year to any one purchaser.
4. The proposed issue of equity and debt securities is for lawful purposes and the money, property, or labor to be obtained by them is required for these purposes. Proceeds from the issue may not be charged to operating expense or income.
5. This authorization is not a finding of the reasonableness of the proposed transactions, nor does it indicate the amounts to be included in ratemaking proceeding.
6. CWS should pay the fee determined in accordance with PU Code § 1904.

ORDER

IT IS ORDERED that:

1. California Water Service Company(CWS), on or after the effective date of this order, is authorized to do the following upon terms and conditions substantially consistent with those set forth or contemplated in Application 96-08-035 (Application):
 - a. Issue and sell not exceeding in aggregate amount \$115,000,000 of any combination of (1) shares of its common stock, (2) shares of its preferred stock, (3) debt securities consisting of any combination of (i) senior notes, (ii) medium term notes, (iii) project specific financing, (iv) monthly income preferred securities (MIPS) or (v) first mortgage bonds and (4) debt securities relating to participation in governmental or agency tax free debt financing;

- b. Determine the precise amount and timing of each financing, the market in and method by which each is effected, price and interest rate and other material terms and provisions (including, if any, the terms of redemption, repurchase, security, and subordination provisions) of the borrowings and of any debt securities related thereto;
- c. To use the net proceeds from the proposed financing in accordance with the provision of PU Code § 817, specifically for capital expenditure, acquisition of property, and redemption of long-term debt.

2. Deferrable interest securities transactions shall be subject to conditions consistent with our findings.

3. CWS shall maintain, and within thirty days from request, provide the Water Division or Finance Branch any or all of the following:

- a. The price, interest rate and other terms pertaining to its issuance of debt securities.
- b. Copies of the purchase and underwriting agreements and the final prospectus pertaining to stock offering.
- c. Copies of the indentures and supplemental indentures setting forth, among other things, the aggregate principal amount, interest rate, conversion factors, redemption and sinking fund requirements and the maturity date of issues of bonds and debentures.
- d. Copies of the agreements setting forth, among other things, the aggregate principal amount, interest rate, final maturity date and other items of any series of notes.

4. On or before the 25th day of each month, CWS shall file the reports required by General Order Series 24.

5. The authority granted by this order shall become effective when CWS pays \$63,500, the fee required by Public Utilities Code § 1904.

6. The Application is granted as set forth above.

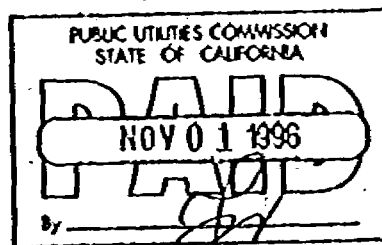
7. This proceeding is closed.

This order is effective today.

Dated October 25, 1996, Sacramento, California.

P. GREGORY CONLON
President
JESSIE J. KNIGHT, JR.
HENRY M. DUQUE
JOSIAH L. NEEPER
Commissioners

Commissioner Daniel Wm. Fessler,
being necessarily absent, did not
participate.



CP# 39164
\$ 63,500 ←