

BEFORE THE PUBLIC UTILITIES COMMISSION  
OF THE STATE OF HAWAII

In the Matter of the Application of )  
HAWAII WATER SERVICE COMPANY, INC. )  
For Approval of Rate Increases and )  
Revised Rate Schedules, and to )  
Enter into Financing Arrangements. )  
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DOCKET NO. 03-0275

ORDER NO. 21340

Filed Sept. 10, 2004  
At 1 o'clock P.M.

Karen Higashi  
Chief Clerk of the Commission

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Commission, State of Hawaii.

K. Higashi

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Docket No. 03-0275

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ORDER

I.

Background

HAWAII WATER SERVICE COMPANY, INC. ("HWSCI" or "HWSC"), fka KAA NAPALI WATER CORPORATION ("KWC"), is a public utility that provides water service in its service area of Kaanapali, island of Maui, pursuant to a commission-issued certificate of public convenience and necessity.<sup>1</sup> HWSCI, a Hawaii corporation, is a wholly-owned subsidiary of California Water Service Group ("CWSG"), a holding company incorporated in Delaware.

On August 5, 2004, the commission denied without prejudice "HWSCI's financing request with respect to the loan amount of \$2.244 million to repay CWSG[.]"<sup>2</sup>

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<sup>1</sup>Decision and Order No. 6230, filed on June 9, 1980, in Docket No. 3700.

<sup>2</sup>Decision and Order No. 21211, filed on August 5, 2004, at 13, Ordering Paragraph 1. The commission approved "HWSCI's financing request with respect to the loan amounts of \$556,000 and \$2.2 million . . . consistent with [Hawaii Revised Statutes] HRS §§ 269-17 and 269-19." Decision and Order No. 21211, at 13, Ordering Paragraph 2. HRS §§ 269-17 and 269-19 are set forth at Section IV, pages 6 - 7, of Decision and Order No. 21211.

On August 17, 2004, HWSCI filed a timely motion for reconsideration ("Motion"), pursuant to Hawaii Administrative Rules ("HAR") §§ 6-61-41 and 6-61-137. HWSCI does not request a hearing on its Motion.

## II.

### Motion - In General

A motion for reconsideration shall set forth "the grounds on which the movant considers the decision or order unreasonable, unlawful, or erroneous." HAR § 6-61-137.

The commission, in denying HWSCI's financing request with respect to the loan amount of \$2.244 million, held:

In its application, HWSCI represented that a portion of "[t]he \$2.8 million in long-term debt will be used . . . to reimburse [CWSG] for equity contributions used to fund capital improvements made since [HWSCI's] last rate increase request."

. . . . .

. . . . .

Thus, HWSCI initially characterized the note as long-term debt, then short-term debt, and now, short-term debt that "has been renewed for another year."

The commission finds that the information in the docket record is insufficient to determine whether the \$2.244 million loan will be used for the purposes designated under HRS § 269-17. The note and HWSCI's CA-IR responses are silent as to the intended purposes of the loan from CWSG to HWSCI. As noted by the Consumer Advocate, HWSCI "failed to explain how the \$2.244 million proceeds used to fund the acquisition from [CWSG] equates to monies spent by HWSC to acquire property, plant and equipment used in the provision of HWSC' regulated water service."

Accordingly, the commission denies, without prejudice, HWSCI's financing request with respect to the loan amount of \$2.244 million.<sup>3</sup>

HWSCI seeks reconsideration of that portion of the commission's decision denying approval of the \$2.244 million loan. HWSCI contends that: (1) it has demonstrated that the proposed \$2.244 million loan is for purposes permitted under HRS § 269-17; and (2) the commission's decision "is unreasonable, since it will result in a capital structure that is more than 90% equity[,] and "[b]ecause the return on equity is higher than the cost of debt, this ruling will have a negative effect on ratepayers."<sup>4</sup>

### III.

#### Motion - HWSCI's Arguments

HWSCI characterizes the \$2.244 million amount as a short-term loan. It then contends that it will use the \$2.244 million loan "for one of two alternative purposes, both of which are permissible under [HRS] § 269-17."<sup>5</sup> Specifically, HWSCI asserts that: (1) the \$2.244 million loan is similar to a permissible financed purchase of HWSCI's assets by a newly created subsidiary; or (2) said loan should be considered a reimbursement to HWSCI for expenditures made for past capital improvements. (See Subsections III(A) and III(B), below.)

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<sup>3</sup>Id. at 9 - 11 (footnotes and text therein omitted).

<sup>4</sup>HWSCI's Motion, at 1 - 2. See also id. at 6 - 7, HWSCI's Capital Structure Section.

<sup>5</sup>Id. at 3.

HWSCI, as a third alternative, requests approval of "the \$2.244 million loan in order to fund the balance of the improvements planned for the test year through 2009."<sup>6</sup>

A.

Hypothetical Asset Purchase

At the outset, HWSCI maintains that "the result of the existing short term \$2.244 million loan is no different than if CWSG had created a new subsidiary to purchase the assets of HWSC, and the new subsidiary had either issued or guaranteed debt used to pay for the purchase."<sup>7</sup> The commission, HWSCI contends, has previously approved such transactions in at least two (2) other dockets, and a similar request is currently pending before the commission.<sup>8</sup>

Here, CWSG financed the purchase of HWSCI through debt and equity. HWSCI, in turn, issued \$2.244 million in short-term debt to CWSG. Under the circumstances, HWSCI reasons that: (1) if CWSG had created a subsidiary to purchase the assets of HWSCI, rather than purchasing the stock, that subsidiary could have issued the debt to finance the purchase under HRS § 269-17;

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<sup>6</sup>Id. at 5.

<sup>7</sup>Id. at 3.

<sup>8</sup>HWSCI cites to Docket No. 03-0051, *In re Citizens Comm. Co, dba The Gas Co., K-1 USA Ventures, Inc., and Hawaii Gas Co., L.L.C., nka The Gas Co., LLC* (approving the sale of The Gas Company's assets); and Docket No. 02-0060, *In re Citizens Comm. Co., Kauai Elec. Div., and Kauai Island Utility Co-op* (approving the sale of Kauai Electric Division's assets). HWSCI further notes that the entities involved in the pending sale of Verizon Hawaii Inc. have made a similar request. See Docket No. 04-0140, *In re Paradise MergerSub., Inc., GTE Corp., Verizon Hawaii Inc., Bell Atlantic Comm., Inc., and Verizon Select Servs. Inc.*

and (2) a public utility should be able to issue debt or other evidence of indebtedness (i.e., a guarantee) to the same extent under a stock sale and a sale of assets.

HWSCI presents a hypothetical situation that is not before the commission and an argument that is not supported by the docket record. HWSCI did not submit any verified evidence that the \$2.244 million loan will be used for purposes permitted under HRS § 269-17. The commission rejects as unpersuasive HWSCI's argument that the proposed \$2.244 million transaction satisfies the requirements of HRS § 269-17 in the present docket.

B.

Reimbursement for Past Capital Expenditures

Although not proven or supported in its responses to the Consumer Advocate's information requests, HWSCI, as an alternative, contends that:

1. The "original \$2.244 million short term loan from CWSG to HWSC should be considered a reimbursement to HWSC (Kaanapali Water Corporation under its former ownership) for expenditures it has made for capital improvements."<sup>9</sup>

2. The commission last approved a financing request for HWSCI in its 1995 rate case.<sup>10</sup> Between 1995 and December 2003, HWSCI made approximately \$3.8 million in capital improvements. Of this amount, approximately \$3 million was paid for by HWSCI.

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<sup>9</sup>HWSCI's Motion, at 4.

<sup>10</sup>Citing Decision and Order No. 13951, filed on June 13, 1995, in Docket No. 94-0056.

3. "Details of improvements that have been placed in service from 1995 through the beginning of the test year (June 2004), and which were not [contributions-in-aid-of-construction] CIAC, are shown on Exhibit 'A' attached hereto. These improvements were all made after HWSC's last request for financing approval, and were therefore paid for either from its income or from equity contributions by CWSG or prior owners of HWSC."<sup>11</sup> Thus, consistent with HRS § 269-17, the amount of moneys actually expended from income or from other moneys in HWSCI's treasury for capital improvements since 1995, is approximately \$3 million.

4. When CWSG purchased HWSCI, the \$2.244 million short term loan was put in place to capitalize HWSCI. "These funds, in effect, reimbursed HWSCI for funds it had previously expended to finance capital improvements. Since the requested \$2.244 million long term loan will be used to repay the existing \$2.244 million short term loan, it is likewise for a permitted purpose."<sup>12</sup>

The commission finds that questions remain under HWSCI's alternative theory, and that its argument is not supported by the docket record. For example:

1. In Docket No. 02-0372, CWSG represented that it was purchasing all of KWC's capital stock for \$7.7 million in

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<sup>11</sup>HWSCI's Motion, at 4 - 5.

<sup>12</sup>Id. at 5.

cash, subject to adjustment at closing.<sup>13</sup> In this Docket No. 03-0275, HWSCI represents that CWSG financed its acquisition of HWSCI with equity and short-term borrowing.<sup>14</sup>

2. "The note and HWSCI's CA-IR responses are silent as to the intended purposes of the loan from CWSG to HWSCI."<sup>15</sup>

3. HWSCI appears to list the \$2.244 million amount as "Other Long-Term Debt" in its "Balance Sheet December 31, 2003."<sup>16</sup> The \$2.244 million, however, does not appear on HWSCI's "Balance Sheet June 30, 2004 and 2003[,] "<sup>17</sup> even though the effective date of the note is April 30, 2004.<sup>18</sup>

4. As stated previously, HWSCI did not submit any verified evidence to support its contention that the \$2.244 million loan will be used for purposes permitted under HRS § 269-17, such as to repay expenditures made for capital improvements.

The commission finds that its previous ruling was not in error. HWSCI has not met its burden of proving that the \$2.244 million loan is for any of the purposes permitted by HRS § 269-17.

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<sup>13</sup>See Decision and Order No. 20102, at 3 - 4; and Docket No. 02-0372.

<sup>14</sup>HWSCI represented that the short-term borrowing includes the \$2.244 million note payable to CWSG.

<sup>15</sup>Decision and Order No. 21211, at 10 (footnote and text therein omitted).

<sup>16</sup>HWSCI's response to CA-IR-1 (rate case).

<sup>17</sup>Id.

<sup>18</sup>HWSCI's response to CA-IR-1(b).



C.

Years 2004 Through 2009 Capital Improvements

HWSCI states that if the commission does not believe that HWSCI has shown that the existing \$2.244 million loan was used for the purposes permitted under HRS § 269-17, HWSCI "requests approval of the \$2.244 million loan in order to fund the balance of the improvements planned for the test year through 2009."<sup>19</sup> HWSCI specifically reasons:

1. HWSCI plans on making approximately \$8 million in capital improvements between 2004 to 2009: (A) \$1.808 million in 2004; (B) \$1.973 million in 2005; and (C) \$1.25 million a year between 2006 and 2009.

2. The commission approved \$556,000 of the \$2.8 million loan and the additional \$2.2 million loan to pay for a portion of these improvements, for a total amount of \$2.756 million.<sup>20</sup> "This leaves approximately \$5.2 million in planned improvements through 2009."<sup>21</sup> As noted by the Consumer Advocate, "even if the \$2.8 million loan should not be used to reimburse CWSG for the initial \$2.2[4]4 million note, monies can be used to finance projects that will be used for the provision of regulated services."<sup>22</sup>

The \$556,000 previously approved by the commission represents monies that will be used to fund test year 2004

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<sup>19</sup>HWSCI's Motion, at 5.

<sup>20</sup>Decision and Order No. 21211, at 11 - 13.

<sup>21</sup>HWSCI's Motion, at 5.

<sup>22</sup>Id. at 5 - 6 (footnote and citation therein omitted).

capital improvements. HWSCI plans to expend a total of \$1.808 million for additions to plant during the 2004 test year period.<sup>23</sup> Thus, HWSCI asks that the commission approve the remaining balance of capital expenditures for the test year, approximately \$1.252 million (\$1.808 million less \$556,000), as part of the \$2.244 million loan under HRS §§ 269-17 and 269-19.

This portion of HWSCI's request, the commission notes, appears consistent in part with HWSCI's application, wherein HWSCI represented that "[t]he \$2.8 million in long-term debt will be used for test year capital improvements[.]"<sup>24</sup> Moreover, HWSCI's planned expenditure of additional funds during the years 2005 to 2009 for other capital improvement projects is supported by the docket record.<sup>25</sup>

Based on the representations made by HWSCI under its third alternative (see Subsection III(C), paragraphs 1 and 2, above), the commission finds that the \$2.244 million loan will be used for purposes permitted under HRS § 269-17, and there is no evidence that this loan will have a materially adverse effect on HWSCI's public utility operations. "The docket record shows that, at a minimum: (1) HWSCI will expend \$3.782 million during the years 2004 and 2005 for additions to plant; and (2) HWSCI

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<sup>23</sup>See Decision and Order No. 21211, at 12; and Exhibit K of HWSCI's application.

<sup>24</sup>Decision and Order No. 21211, at 4 (citing to HWSCI's application, at 7).

<sup>25</sup>Decision and Order No. 21211, at 12.

projects 'an annual capital budget of \$1.25 million in 2006 through 2009.'"<sup>26</sup>

Moreover, "the encumbrance of HWSCI's utility assets under HRS § 269-19 is consistent with the public interest, as the monies will be used to fund plant additions and other capital improvements for HWSCI's utility operations."<sup>27</sup>

Upon careful review of HWSCI's new proposal, the commission grants HWSCI's alternative request, because the \$2.244 million loan will be used for purposes permitted under HRS § 269-17.

#### IV.

##### Orders

##### THE COMMISSION ORDERS:

1. HWSCI's Motion for Reconsideration, filed on August 17, 2004, is granted. Thus, based on HWSCI's third alternative proposal, HWSCI's financing request with respect to the loan amount of \$2.244 million is approved, consistent with HRS §§ 269-17 and 269-19. HWSCI: (A) shall use the \$2.244 million amount consistent with the purposes permitted in Subsection III(C), above; and (B) is precluded from using the \$2.244 million loan to reimburse or repay CWSG pursuant to the outstanding note.

2. The conditions set forth in Ordering Paragraphs 3 to 7 of Decision and Order No. 21211, filed on August 5, 2004,

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<sup>26</sup>Id. (footnote and citation therein omitted)

<sup>27</sup>Id.

are incorporated herein by reference and is made a part of this Order.

DONE at Honolulu, Hawaii: SEP 10 2004.

PUBLIC UTILITIES COMMISSION  
OF THE STATE OF HAWAII

By Carlito P. Caliboso  
Carlito P. Caliboso, Chairman

By Wayne H. Kimura  
Wayne H. Kimura, Commissioner

By Janet E. Kawelo  
Janet E. Kawelo, Commissioner

APPROVED AS TO FORM:

Michael Azama

Michael Azama  
Commission Counsel

03-0275.sl

CERTIFICATE OF SERVICE

I hereby certify that I have this date served a copy of the foregoing Order No. 21340 upon the following parties, by causing a copy hereof to be mailed, postage prepaid, and properly addressed to each such party.

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DATED: SEP 10 2004