

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF HAWAII

In the Matter of the Application of)

KAUPULEHU WATER COMPANY and)
KAUPULEHU WASTE WATER COMPANY)

DOCKET NO. 2006-0147

For Approval of the Sale and)
Transfer of the Partnership)
Interests of Kaupulehu Water)
Company and Kaupulehu Waste Water)
Company and Related Matters)

DECISION AND ORDER NO. 23099

Filed Dec. 4, 2006
At 12 o'clock P.M.

Karen Higashi
Chief Clerk of the Commission

DIV. OF CONSUMER ADVOCACY
DEPT. OF COMMERCE AND
CONSUMER AFFAIRS
STATE OF HAWAII

2006 DEC -5 A 8:50

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KAREN HIGASHI
Chief Clerk, Public Utilities
Commission, State of Hawaii.

K. Higashi

OF THE STATE OF HAWAII

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DECISION AND ORDER

By this Decision and Order, the commission approves the application¹ of KAUPULEHU WATER COMPANY ("KWC") and KAUPULEHU WASTE WATER COMPANY ("KWWC") (collectively, "Applicants"), and HUALALAI UTILITY GP, LLC ("HUGL") and HUALALAI INVESTORS, LLC ("HIL") (collectively, "Purchasers"), filed on June 1, 2006. Specifically, subject to certain conditions stated herein, the commission approves Applicants' and Purchasers' requests for approval of (1) the Partnership Interest Purchase and Sale Agreement dated as of March 6, 2006 (the "Agreement"); (2) the sale and transfer of the respective general partnership interests of Applicants currently owned by

¹Application for Approval of the Sale and Transfer of the Partnership Interests of Kaupulehu Water Company and Kaupulehu Waste Water Company and Related Matters; Exhibits A and B; Verifications; and Certificate of Service filed on June 1, 2006 (collectively, "Application"). Copies of the Application were served on the DIVISION OF CONSUMER ADVOCACY, DEPARTMENT OF COMMERCE AND CONSUMER AFFAIRS ("Consumer Advocate"), an ex officio party to this docket pursuant to Hawaii Revised Statutes ("HRS") § 269-51 and Hawaii Administrative Rules ("HAR") § 6-61-62.

Kaupulehu Utility Corporation ("KUC") to HUGL (the "General Partnership Interests"); (3) the sale and transfer of the respective limited partnership interests of Applicants currently owned by Kaupulehu Makai Venture ("KMV") to HIL (the "Limited Partnership Interests")²; and (4) HIL's pledge of its direct and indirect ownership interests in Applicants as security in favor of German American Capital Corporation (together with its successors and assigns, "GACC"). The commission declines to opine on whether, in connection with the above, following the closing of the purchase and sale of the Transferred Partnership Interests, the Purchasers shall own and control 100% of the respective general and limited partnership interests of Applicants, subject to the security interests in favor of GACC.

I.

Background

A.

The Subject Entities

Applicants KWC and KWWC are Hawaii limited partnerships whose general partner is KUC, a Hawaii corporation, and limited partner is KMV, a California general partnership. KWC is the holder of a certificate of public convenience and necessity ("CPCN"), issued in Docket No. 94-0300, authorizing KWC to provide water utility services in the ahupua'a of Kaupulehu,

²KUC and KMV are collectively referred to as "Sellers." The Limited Partnership Interests and General Partnership Interests are collectively referred to as the "Transferred Partnership Interests."

Hawaii County, Hawaii.³ KWWC is the holder of a CPCN, issued in Docket No. 95-0278, authorizing KWWC to provide wastewater utility services in the ahupua'a of Kaupulehu, Hawaii County, Hawaii.⁴

Purchasers HUGL and HIL are both Delaware limited liability companies. HUGL's sole member is HIL,⁵ and HIL's sole member is Hualalai Investors Mezz, LLC ("HIML"), a Delaware limited liability company. HIML's sole member is Hualalai Investors, JV, LLC ("HIJV"), also a Delaware limited liability company. HIJV is a joint venture in which the membership interests are equally and ultimately owned by affiliates of MSD Capital Management, LLC ("MSD"), a Delaware limited liability company, and Rockpoint Real Estate Fund II GP, LLC ("Rockpoint"), a Delaware limited liability company.⁶

³KWC provides water services to its customers at rates approved in Decision and Order No. 22199, filed on December 29, 2005, in Docket No. 05-0124, and in accordance with its current Rules and Regulations, approved in Order No. 22227, filed on January 17, 2006, in Docket No. 05-0124.

⁴KWWC provides wastewater services to its customers at rates approved in Decision and Order No. 19812, filed on November 22, 2002, in Docket No. 01-0275, and in accordance with its Rules and Regulations approved in Decision and Order No. 14760, filed on July 1, 1996, in Docket No. 95-0278, amended in Docket No. 01-0275.

⁵HIL currently has approximately \$31 million in escrowed deposits as assets, and upon acquisition of the Hualalai Resort, will have \$200 million of equity invested in that resort. See Application at 8.

⁶Rockpoint's controlling entity, Rockpoint Group, L.L.C. ("Rockpoint Group"), a Delaware limited liability company, is a global real estate investment management firm that has raised in excess of \$2.7 billion of capital since its inception. See Application at 7.

MSD Capital, L.P. ("MSD Capital") is a Delaware limited partnership and MSD's subsidiary.⁷

Sellers KUC and KMV are holders of 100% of the general and limited partnership interests in Applicants. KUC holds 100% of the right, title, and interest in and to the General Partnership Interests. KMV holds 100% of the right, title, and interest in and to the Limited Partnership Interests.

B.

Application

On June 1, 2006, Applicants and Purchasers filed their Application, pursuant to HRS § 269-19, and HAR Title 6, Chapter 61, Subchapters 6, 9, and 10, in which they request that the commission:

1. Approve the [Agreement], as set forth in Exhibit A [to the Application];
2. Approve, pursuant to HRS § 269-19, the sale and transfer to HUGL of the [General Partnership Interests] currently owned by [KUC];
3. Approve, pursuant to HRS § 269-19, the sale and transfer to HIL, of the [Limited Partnership Interests] currently owned by [KMV];
4. Approve, if necessary, the pledge as security of HIL's direct and indirect ownership of the Transferred Partnership Interests in [Applicants] in favor of [GACC] and related transactions;
5. In connection with the above, approve and/or confirm that, following the closing of the purchase and sale of the

⁷MSD Capital is an investment firm with assets under management in excess of \$10 billion. See Application at 7.

Transferred Partnership Interests, that the Purchasers shall own and control 100% of the respective general and limited partnership interests of [Applicants] subject to the security interests in favor of GACC; and

6. Grant such other relief as may be just and reasonable under the circumstances. [Specifically, to the extent that HRS § 269-17.5 applies to the instant transaction, approval of the transactions under such provision is also requested.]⁸

According to Applicants, on March 6, 2006, Sellers entered into the Agreement with MSD Capital, through which MSD Capital will purchase the Transferred Partnership Interests from Sellers once all obligations and conditions of the parties are satisfied. Effective as of March 6, 2006, MSD Capital assigned its right, title, and interest in the Agreement to HIL.⁹ On April 7, 2006, HIL assigned its right, title, and interest to acquire the General Partnership Interests to HUGL.¹⁰ Thus, through the Agreement, HUGL is acquiring 100% of the General Partnership Interests, and HIL is acquiring 100% of the Limited Partnership Interests.¹¹

The \$21 million purchase of the Transferred Partnership Interests will be partially funded through financing from GACC, with the balance internally funded through equity contributions

⁸Application at 3-4 and n.6 (footnotes omitted).

⁹See Application at 8 n.7.

¹⁰See Application at 8 n.7..

¹¹See Application at 8.

made by HIL and its affiliates.¹² The loan financing will be partially secured by a pledge of all of HIL's direct and indirect ownership interests in Applicants in favor of GACC.¹³ This sale by Sellers is part of an overall transaction in which HIL and certain of its affiliates have agreed to purchase the fee and leasehold interests in the Hualalai Resort development from KMV and its affiliates.¹⁴

Purchasers, as owners of 100% of the general and limited partnership interests of Applicants, will control the water and wastewater utility assets and business, including the respective CPCNs of Applicants.¹⁵ As a part of this acquisition, Purchasers will assume, among other things, the three existing contracts Applicants have with American Water Operations & Maintenance, Inc. ("AWOM") for the operation and maintenance of the respective water facilities, and the reverse osmosis plant

¹²See Application at 12. To consummate the overall purchase of the subject utilities and resort, HIL will, through its affiliates, invest approximately \$200 million in equity and obtain financing in the amount of \$375 million from GACC, an affiliate of Deutsche Bank Securities Inc. See Application at 10. Additionally, GACC will, subject to HIL's compliance with certain borrowing requirements, provide a construction loan of up to \$55 million for the construction of certain improvements within the Hualalai Resort, including the expansion of the hotel. See Application at 10.

¹³See Application at 10. Because HIL is the sole member of HUGL, HIL will pledge its indirect interests in HUGL's acquisition of the General Partnership Interests to GACC. See Application at 15 n.12. GACC is also requiring HIL to provide a collateral assignment in the Agreement. See Application at 10.

¹⁴See Application at 9.

¹⁵See Application at 8-9.

required for the water operations and the wastewater service facilities.¹⁶

C.

The Consumer Advocate's Position

On September 19, 2006, the Consumer Advocate filed its Statement of Position ("Consumer Advocate SOP"), in which it states that it does not object to approval of the requests set forth in the Application.¹⁷ In its Statement of Position, the Consumer Advocate considered the following:

1. Whether the sale is reasonable and the Applicants and Purchasers are fit, willing and able to continue the provision of water service and wastewater collection, treatment, and disposal services.
2. Whether the proposed transaction is in the public interest and will not have an adverse impact on the Applicants' customers.¹⁸

The Consumer Advocate states that "the sale [of the Transferred Partnership Interests] is reasonable, and that Applicants and Purchasers are fit, willing, and able to assume ownership of the subject utilities and to continue providing the water and wastewater services currently being received by customers."¹⁹ In addition, the Consumer Advocate states that "the proposed purchase and sales transaction [is] in the public interest with

¹⁶See Application at 9.

¹⁷See Consumer Advocate SOP at 1.

¹⁸Consumer Advocate SOP at 5.

¹⁹Consumer Advocate SOP at 6.

no adverse impact on the Applicants' existing customers."²⁰ However, the Consumer Advocate recommends that "if approved by the Commission, Applicants be required to submit an accounting of the proposed transaction," and that "the Commission order Applicants to record all costs directly or indirectly related to the acquisition of the partnership interest in [Applicants] and any acquisition premium paid by buyer in 'below-the-line' accounts."²¹

II.

Discussion

Applicants and Purchasers request commission approval of their Application, pursuant to HRS § 269-19. Section 269-19 provides, in relevant part:

No public utility corporation shall sell, lease, assign, mortgage, or otherwise dispose of or encumber the whole or any part of its road, line, plant, system, or other property necessary or useful in the performance of its duties to the public, or any franchise or permit, or any right thereunder, nor by any means, directly or indirectly, merge or consolidate with any other public utility corporation without first having secured from the public utilities commission an order authorizing it so to do. Every such sale, lease, assignment, mortgage, disposition, encumbrance, merger, or consolidation, made other than in accordance with the order of the commission shall be void.

²⁰Consumer Advocate SOP at 7.

²¹Consumer Advocate SOP at 8-9.

HRS § 269-19. The purpose of HRS § 269-19 is to safeguard the public interest.²²

In addition, the commission is empowered under HRS § 269-7(a) to examine the condition of a public utility, the manner in which it is operated with reference to the safety or accommodation of the public, "and all matters of every nature affecting the relations and transactions between it and the public or persons or corporations." Accordingly, the commission, under HRS § 269-7(a), has the authority to examine any and all transactions of the public utility that affect or may affect the public that it serves.

A.

The Agreement, the Transfer of the General Partnership Interests, and the Transfer of the Limited Partnership Interests

1.

Financial Fitness

The Application states that Purchasers have or will have the financial fitness and ability to fund the continuing operations of Applicants, both through internal resources and through revenue generated from the utility operations being acquired through the purchase of the Transferred Partnership Interests.²³ Purchasers are funding the purchase of the

²²See In re Honolulu Rapid Transit Co., 54 Haw. 402, 409, 507 P.2d 755, 759 (1973).

²³See Application at 12.

Transferred Partnership Interests through a combination of financing from GACC and financing from equity contributions.²⁴

Upon reviewing the record and taking official notice of all pertinent documents in the commission's records, pursuant to HAR § 6-61-48, we agree with the Consumer Advocate,²⁵ and find that Purchasers have the requisite financial fitness to properly perform the subject water and wastewater services.

2.

Willingness

The Application states that

Purchasers' willingness to assume the responsibilities of acquiring the Transferred Partnership Interests and assuming control of the respective utilities is evident from the considerable time, effort, and energy spent negotiating the Agreement, the significant amount of funds expended and anticipated to be expended in connection with the proposed acquisition, and by its joinder in the filing of this Application requesting regulatory approval of the subject transaction.²⁶

Upon reviewing the record and taking official notice of all pertinent documents in the commission's records, pursuant to HAR § 6-61-48, we agree with the Consumer Advocate,²⁷ and find that Purchasers have demonstrated the requisite willingness to properly perform the subject water and wastewater services.

²⁴See Application at 12.

²⁵See Consumer Advocate SOP at 6.

²⁶Application at 12.

²⁷See Consumer Advocate SOP at 6.

3.

Ability

The Application states that operations of the subject utilities "are not affected by the transaction because the transaction "involves the transfer of 100% of the general and limited partnership interests of Applicants owned by KUC and KMV, respectively."²⁸ Among other things, AWOM, the current operator of the water operations (including the reverse osmosis plant) and wastewater operations of Applicants, will continue to operate both utility facilities pursuant to the existing agreements in effect.²⁹

Upon reviewing the record and taking official notice of all pertinent documents in the commission's records, pursuant to HAR § 6-61-48, we agree with the Consumer Advocate,³⁰ and find that Purchasers have demonstrated the requisite ability to properly perform the subject water and wastewater services.

4.

The Public Interest

The Application states that the transfer of 100% of the partnership interests of Applicants to Purchasers is reasonable and in the public interest for the following reasons:

- (a) Rates. Purchasers have no current intention to seek a general rate increase for Applicants as a result of the

²⁸Application at 12.

²⁹See Application at 13.

³⁰See Consumer Advocate SOP at 6.

contemplated transfer of partnership interests.³¹

- (b) Capital Improvements. Purchasers are committed to making future capital improvements to expand and improve the existing water and wastewater facilities necessary for the continued operations of the respective public utilities. Any funding for such capital improvements will be generated through the operations of the respective utilities as well as through Purchasers' internal and external resources.³²

In addition, the Application states that by retaining AWOM to operate the utility facilities, the operation of these facilities will continue uninterrupted.³³ The Application further contends that there will be no "transition period," and that the transfer of partnership interests in Applicants will be seamless and transparent to Applicants' customers.³⁴

Upon reviewing the record and taking official notice of all pertinent documents in the commission's records, pursuant to HAR § 6-61-48, we agree with the Consumer Advocate,³⁵ and find that the proposed purchase and sales transaction is in the public interest, with no adverse impact on Applicants' existing customers.

³¹See Application at 14 and 4 n.5.

³²See Application at 14.

³³See Application at 13.

³⁴See Application at 13.

³⁵See Consumer Advocate SOP at 7.

5.

Conformance to the Commission's Rules and Orders

The Application states that

Purchasers, as the prospective owners of 100% of the partnership interests of [Applicants], commit and agree that they shall abide by and conform to all applicable Commission rules and orders upon closing of the purchase and sale of the Transferred Partnership Interests, if approved. Purchasers, as successor to [Sellers]'s interests in [Applicants], will continue to cause [Applicants] to be subject to and abide by all rights and obligations currently imposed on those entities in connection with applicable Commission orders, rules, and regulations and will continue to be so bound. All rights and obligations of [Applicants] under all outstanding permits, contracts and other agreements that remain in effect following the closing will continue to be followed.³⁶

Upon reviewing the record and taking official notice of all pertinent documents in the commission's records, pursuant to HAR § 6-61-48, we find that Purchasers have demonstrated the requisite commitment to conform to the commission's terms, conditions, and rules.

6.

An Accounting of the Proposed Transaction

Public utilities may not recover transaction costs, implementation costs, or acquisition premiums that are directly or indirectly attributable to the acquisition or merger of the

³⁶Application at 13-14.

utility by or with another.³⁷ Thus, the Consumer Advocate recommends that if the proposed transaction is approved by the commission, Applicants be required to submit an accounting that shows the amount paid for each of the partnership interests in each of the Applicants, and any premiums paid above the net book value of the each of the partnership interests in each of the Applicants.³⁸ The Consumer Advocate explains that this will "ensure that any attempt by the Purchasers to recover the acquisition premium in any form from the ratepayers is denied in future rate proceedings."³⁹

In addition, the Consumer Advocate recommends that until the next rate case, Applicants be required to "record all costs directly or indirectly related to the acquisition of the partnership interest in [Applicants] and any acquisition premium paid by buyer in 'below-the-line' accounts."⁴⁰ The Consumer Advocate explains that "[t]his separate recording of costs is necessary to prevent the recovery of any acquisition premium or transaction or implementation costs incurred by buyer in future KWC and/or KWWC rate proceedings."⁴¹

³⁷See, e.g., In re BHP Hawaii, Inc., Gasco Inc., and Citizens Utilities Company, Docket No. 97-0035, Decision and Order No. 15899, filed on Sept. 10, 1997, at 8 ("We have never allowed, and will not now allow, a public utility to recover an acquisition premium or transaction or implementation cost attributable, directly or indirectly, to the acquisition or merger of one utility by or with another.").

³⁸See Consumer Advocate SOP at 8.

³⁹Consumer Advocate SOP at 8.

⁴⁰Consumer Advocate SOP at 9.

⁴¹Consumer Advocate SOP at 9.

Upon reviewing the record and taking official notice of all pertinent documents in the commission's records, pursuant to HAR § 6-61-48, we find that Applicants should be required to (a) file an accounting of the proposed transaction that shows the amount paid for each of the partnership interests in each of the Applicants, and any premiums paid above the net book value of the each of the partnership interests in each of the Applicants; and (b) until the next rate case, record all costs directly or indirectly related to the acquisition of the partnership interests in Applicants, and any acquisition premium paid by buyer, in "below-the-line" accounts.

Accordingly, subject to the foregoing conditions, the commission concludes that Applicants have sufficiently demonstrated that (1) the Agreement should be approved, (2) the sale and transfer to HUGL of the General Partnership Interests should be approved, and (3) the sale and transfer to HIL of the Limited Partnership Interests should be approved.

B.

The Pledge of HIL's Direct and Indirect Ownership Interests

Applicants and Purchasers further request approval to allow HIL to pledge its direct and indirect ownership interests in Applicants as security in favor of GACC.⁴² As part of the overall transaction to purchase the Hualalai Resort development, HIL will be obtaining \$375 million in financing from GACC.⁴³

⁴²See Application at 15 and n.13.

⁴³See Application at 10, 15.

The Application states that "[a]lthough only a small portion of the overall financing will be utilized in connection with Applicant's acquisition of the Transferred Partnership Interests of Applicants, GACC is requiring HIL to pledge its ownership interests in [Applicants] as part of the collateral for the loan."⁴⁴ In addition, GACC is also requiring HIL to provide a collateral assignment of the Agreement effective as of the date of the other transactions.⁴⁵

Upon reviewing the record and taking official notice of all pertinent documents in the commission's records, pursuant to HAR § 6-61-48, we find that the pledge of HIL's direct and indirect ownership interests in Applicants as security in favor of GACC should be approved.

C.

The Extent of Purchasers' Ownership

The commission declines to opine on whether the sale and transfer of the Transferred Partnership Interests will result in Purchasers owning and controlling 100% of the respective general and limited partnership interests of Applicants, subject to the security interests in favor of GACC.⁴⁶ Unless otherwise stated, all references to the extent of Purchasers' ownership

⁴⁴Application at 15.

⁴⁵See Application at 10.

⁴⁶The Consumer Advocate concludes that because HIL is the sole member of HUGL, the Agreement will result in HIL having 100% ownership of Applicants via its direct acquisition of their limited partnership interests and indirect acquisition of their general partnership interests through HUGL. See Consumer Advocate SOP at 5.

contained in this Order are based upon the representations made in the Application.

III.

Orders

THE COMMISSION ORDERS:

1. The Partnership Interest Purchase and Sale Agreement, dated as of March 6, 2006, is approved, pursuant to HRS §§ 269-7(a) and 269-19, and subject to the conditions stated in paragraphs 5 and 6.

2. The sale and transfer to HUGL of the respective general partnership interests of Applicants current owned by KUC is approved, pursuant to HRS §§ 269-7(a) and 269-19, and subject to the conditions stated in paragraphs 5 and 6.

3. The sale and transfer to HIL of the respective limited partnership interests of Applicants currently owned by KMV is approved, pursuant to HRS §§ 269-7(a) and 269-19, and subject to the conditions stated in paragraphs 5 and 6.

4. The pledge of HIL's direct and indirect ownership interests in Applicants as security in favor of GACC is approved, pursuant to HRS §§ 269-7(a) and 269-19.

5. Within thirty (30) days of the closing of the Agreement, Applicants shall file an accounting of the proposed transaction with the commission, with additional copies served on the Consumer Advocate. The accounting should clearly show the amount paid for each of the partnership interests in each of the

Applicants, and any premiums paid above the net book value of each of the partnership interests in each of the Applicants.

6. Until the next rate case, Applicants are required to separately record all costs directly or indirectly related to the acquisition of the partnership interests in Applicants, and any acquisition premiums paid, in "below-the-line" accounts. Except as discussed in paragraph 5 above, this accounting shall be submitted in any future KWC or KWCC rate case proceedings.

7. Applicants shall promptly comply with the requirements set forth in paragraphs 5 and 6 above. Failure to promptly comply with these requirements may constitute cause to void this decision and order, and may result in further regulatory action, as authorized by law.

DONE at Honolulu, Hawaii DEC - 4 2006.

PUBLIC UTILITIES COMMISSION
OF THE STATE OF HAWAII

By Carlito P. Caliboso
Carlito P. Caliboso, Chairman

By John E. Cole
John E. Cole, Commissioner

APPROVED AS TO FORM:

Nichole K. Shimamoto
Nichole K. Shimamoto
Commission Counsel
2006-0147.eh

CERTIFICATE OF SERVICE

I hereby certify that I have this date served a copy of the foregoing Decision and Order No. 23099 upon the following, by causing a copy hereof to be mailed, postage prepaid, and properly addressed to each such party.

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DATED: DEC - 4 2006