BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF HAWAII

In the Matter of the Application of

HAWAII-AMERICAN WATER COMPANY

DOCKET NO. 2008-0035

For Approval of Financing and
Security Arrangements.

DECISION AND ORDER
BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF HAWAII

In the Matter of the Application of)
HAWAI-AMERICAN WATER COMPANY ) Docket No. 2008-0035
) For Approval of Financing and
) Security Arrangements.
)_______________________________

DECISION AND ORDER

By this Decision and Order, the commission approves
HAWAI-AMERICAN WATER COMPANY’s ("HAWC") request to enter into
certain financing and security arrangements, pursuant to
Hawaii Revised Statutes ("HRS") §§ 269-17, 269-19, and 269-7(a),
subject to certain conditions described herein.

I.

Background

HAWC, a Nevada corporation,¹ is a public utility
authorized to provide wastewater collection, treatment, and
disposal services to the residences, condominiums, and

¹American Water Works Company, Inc. ("American Water"), a Delaware corporation, is HAWC’s sole shareholder. In turn, American Water’s stock is currently held by RWE Aqua Holdings GmbH, fka Thames Water Aqua Holdings GmbH, which is a subsidiary of RWE Aktiengesellschaft, a foreign corporation organized under the laws of the Federal Republic of Germany. By Decision and Order No. 22511, filed on June 5, 2006, in Docket No. 2006-0095, the commission conditionally approved the sale of up to 100% of American Water’s common stock in one or more public offerings.
commercial establishments in the Hawaii Kai community on the island of Oahu, State of Hawaii.²

A.

HAWC's Application

On February 13, 2008, HAWC filed an application for commission approval of certain financing and related security arrangements in accordance with HRS §§ 269-17, 269-19, and 269-7(a).³ Specifically, HAWC seeks to issue securities to its affiliate American Water Capital Corp. ("AWCC"), pursuant to a Financial Services Agreement dated June 15, 2000 ("Agreement") between HAWC and AWCC.⁴ The Agreement allows HAWC to obtain financing and access financial or capital markets on favorable terms and conditions via AWCC, which was formed to borrow funds for the benefit of American Water and its regulated operating subsidiaries.⁵

²In addition to its operations on Oahu, HAWC provides wastewater services on the island of Hawaii. See In re Mauna Lani STP, Inc. and Hawaii-American Water Company, Docket No. 05-0229, Decision and Order No. 22299, filed on February 28, 2006.

³Application; Exhibits 1 – 6; Verification; and Certificate of Service, filed on February 13, 2008 (collectively, "Application"). HAWC served copies of its Application upon the DEPARTMENT OF COMMERCE AND CONSUMER AFFAIRS, DIVISION OF CONSUMER ADVOCACY ("Consumer Advocate"), an ex officio party to this proceeding, pursuant to HRS § 269-51 and Hawaii Administrative Rules ("HAR") § 6-61-62(a).

⁴Application, at 6.

⁵Application, at 6 n.13.
HAWC proposes to issue, through AWCC, either senior unsecured note(s); or first mortgage bond(s) secured by HAWC’s property in an aggregate principal amount not to exceed $18 million. According to HAWC, the note(s) or bond(s) will have an effective interest rate "not to exceed the comparable maturity period of U.S. Treasuries, plus 200 basis points, and for a term of not less than 5 years but in no event greater than 30 years."^7

"Upon [HAWC’s] issuance of the note(s)/bond(s), [HAWC] will be liable only for repayment of the note(s)/bond(s) in accordance with its terms and will have no liability or obligations with respect to the debt instruments issued by AWCC or the note(s)/bond(s) issued to AWCC by the other operating subsidiaries."^8 HAWC states that "[a]t this juncture, [it] does not yet know the exact interest rate(s) or the specific salient term(s) of the note(s)/bond(s) as AWCC is or will be in the process of pooling the long-term debt financing requirements of the operating companies that comprise the American Water system including, without limitation, [HAWC]. The debt issued by AWCC will be either in the public or private equity markets to obtain the best available pricing . . . [and] the note(s)/bond(s) to be issued by HAWC will bear interest at

^6Application, at 6 and n.12.
^7Application, at 7.
^8Application, at 7.
the rates paid by AWCC and will be payable at the duration and in the manner that AWCC's debt instruments are payable."

According to HAWC, the proposed financing will be used for the following purposes: 1) refinance HAWC's $9 million long-term unsecured senior note with CoBank, ACB, which was authorized by the commission in Decision and Order No. 17803, filed on July 16, 1999, in Docket No. 99-0072; 2) convert or reorganize HAWC's existing $7 million short-term unsecured promissory note with AWCC executed on March 31, 2006, to a long-term promissory note with AWCC; and 3) fund capital improvement projects in the amount of $2 million.

HAWC asserts that the financing and security arrangements are in the public interest, since HAWC "will incur lower costs of issuance and more favorable interest rates than if it were required to obtain financing on its own, thereby minimizing the costs to HAWC's ratepayers of debt capital needed to acquire, construct and maintain adequate utility plant and property." HAWC also states that "the rate at which AWCC will secure the funds will be lower than had HAWC had to borrow the funds separately"; and "the proposed financing and security arrangements will not impair [HAWC's] financial status, will not impair its ability to attract capital, nor will it

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9 Application, at 7.
10 Application, at 8.
11 Application, at 10.
impair [HAWC’s] ability to provide safe, reliable and adequate services."^{12}

B

Consumer Advocate’s Position

On July 3, 2008, the Consumer Advocate filed its Statement of Position, informing the commission that it does not object to the approval of the Application, subject to certain conditions. The Consumer Advocate states that "[i]f approved, the proposed financing will provide the funds needed by [HAWC] to acquire plant deemed necessary for the wastewater collection and treatment services and repay existing debt that was incurred for the aforementioned purpose, consistent with the statutory requirements of HRS § 269-17"; that "[i]f approved, [HAWC’s] projected financial results indicate an expectation that HAWC will be able to generate sufficient cash from operations to meet the debt service obligations, thereby avoiding a default on the debt. Thus, the proposed financing and security agreement (if needed) are not expected to impair HAWC's ability to continue the provision of the regulated services"; and finally that "[t]he lower cost of debt that is expected to result from having AWCC issue the debt securities, and lend the necessary funds to HAWC on the same terms and conditions as AWCC incurs to acquire the funds is believed to be in the public interest."^{13}

^{12}Application, at 10.

^{13}Consumer Advocate’s SOP, at 14-15.
The Consumer Advocate, however, conditioned its recommendation on HAWC's compliance with the following filing requirements:

1. If the financing is done through first mortgage bonds that are secured by HAWC's property, the Consumer Advocate recommends that HAWC be required to notify the Commission and Consumer Advocate of the terms of the security, describe the plant, property and/or equipment that is pledged as collateral on the debt instrument and provide a copy of the mortgage and encumbrance document as required by HAR § 6-61-105(c)(2).

2. When the specific terms of the financing are known, HAWC should make an informational filing that sets forth such terms and conditions (e.g., amount of debt by type, interest rate on each type of debt, term of each type of debt, issuance costs, etc.). In addition, if the spread between the interest rate of the debt issuance by AWCC and the U.S. Treasuries for comparable terms is greater than 200 basis points, AWCC, through HAWC should provide information to support the higher interest rate.

3. HAWC should make an informational filing that identifies the utility assets that were acquired with the $5.9 million of funds.¹⁴

C.

HAWC's Response

In its Response filed on July 8, 2008,¹⁵ HAWC states that it does not object to the Consumer Advocate's three recommended regulatory conditions and therefore this docket is ready for decision-making by the commission.¹⁶

¹⁴Consumer Advocate's SOP, at 15-16.

¹⁵HAWC's Response Statement to the Consumer Advocate's Statement of Position; and Certificate of Service, filed on July 8, 2008 (collectively, "Response").

¹⁶HAWC's Response, at 3.
II.

Discussion

HRS § 269-17 provides that, upon the commission's prior approval, a public utility corporation may issue stocks and stock certificates, bonds, notes, and other evidences of indebtedness, payable at periods of more than twelve (12) months after the date thereof, for the following purposes, and no other:

- for the acquisition of property or for the construction, completion, extension, or improvement of or addition to its facilities or service, or for the discharge or lawful refunding of its obligations or for the reimbursement of moneys actually expended from income or from any other moneys in its treasury not secured by or obtained from the issue of its stocks or stock certificates, or bonds, notes, or other evidences of indebtedness, for any of the aforesaid purposes except maintenance of service, replacements, and substitutions not constituting capital expenditure in cases where the corporation has kept its accounts for such expenditures in such manner as to enable the commission to ascertain the amount of moneys so expended and the purposes for which the expenditures were made, and the sources of the funds in its treasury applied to the expenditures.

HRS § 269-17.

Conversely, "[a] public utility corporation may not issue securities to acquire property or to construct, complete, extend or improve or add to its facilities or service if the commission determines that the proposed purpose will have a material adverse effect on its public utility operations."¹⁷

"All stock and every stock certificate, and every bond, note, or other evidence of indebtedness of a public utility corporation

¹⁷HRS § 269-17.
not payable within twelve months, issued without an order of the commission authorizing the same, then in effect, shall be void."^{18}

Thus, the permitted purposes contemplated under HRS § 269-17 are limited to:

1. The acquisition of property;
2. The construction, completion, extension, or improvement of or addition to its facilities or service;
3. The discharge or lawful refunding of its obligations; or
4. The reimbursement of moneys actually expended for any of the above purposes.^{19}

"Purposes 1 and 2 of [HRS § 269-17] contemplate situations where funds for capital acquisition or construction are to be expended after or nearly contemporaneously with the issuance of securities. On the other hand, purposes 3 and 4 relate to the past expenditure of funds, e.g., purpose 3 contemplates the discharge or refinancing of debt incurred in the past for the acquisition or construction of capital facilities."^{20}

HRS § 269-19 provides that no public utility 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, nor by any means, directly or

^{18}Id.
^{20}Id. at 43.
indirectly, merge or consolidate with any other public utility, without first having secured from the 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." The purpose of HRS § 269-19 is to safeguard the public interest.21

In addition, HRS § 269-7(a) authorizes the commission to examine the condition of each public utility, its financial transactions, and "all matters of every nature affecting the relations and transactions between it and the public or persons or corporations."

Here, based on the representations made by HAWC in its Application, together with the Consumer Advocate's recommendations, the commission finds that approval of the Application is appropriate. The proceeds from the financing arrangements, as asserted by HAWC, will be used for purposes permitted under HRS § 269-17; and there is no evidence in the docket record that the financing arrangements will have a materially adverse effect on HAWC's utility operations.

In addition, should the proposed financing involve issuance of mortgage bond(s) secured by HAWC's property, the commission finds that the encumbrance of HAWC's utility assets under HRS § 269-19, is consistent with the public interest.

As stated by the Consumer Advocate, the pledge of assets "is not expected to impair HAWC's ability to provide the regulated service since [HAWC's] projections indicate an ability of HAWC to meet the debt obligations"; and "the proposed financing is not expected to impair HAWC's creditworthiness as demonstrated by the existing and projected pre-tax interest coverage ratios and the projected capital structure."  

Accordingly, the commission approves the proposed financing and security arrangements, pursuant to HRS §§ 269-17, 269-19, and 269-7(a), subject, however, to the conditions recommended by the Consumer Advocate:

1. If the financing is done through first mortgage bonds that are secured by HAWC's property, HAWC shall notify the Commission and Consumer Advocate of the terms of the security, describe the plant, property and/or equipment that is pledged as collateral on the debt instrument and provide a copy of the mortgage and encumbrance document as required by HAR § 6-61-105(c)(2).

2. When the specific terms of the financing are known, HAWC shall make an informational filing that sets forth such terms and conditions (e.g., amount of debt by type, interest rate on each type of debt, term of each type of debt, issuance costs, etc.). In addition, if the spread between the interest rate of the debt issuance by AWCC and the U.S. Treasuries for comparable terms is greater than 200 basis points, AWCC, through HAWC should provide information to support the higher interest rate.

3. HAWC shall make an informational filing that identifies the utility assets that were acquired with the $5.9 million of funds.

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22Consumer Advocate's SOP, at 8-9.
III.

Orders

THE COMMISSION ORDERS:

1. The financing and security arrangements, as described by HAWC in its Application, filed on February 13, 2008, are approved, subject to HAWC complying with the following conditions:

   A. If the financing is obtained through first mortgage bonds that are secured by HAWC's property, HAWC shall notify the Commission and Consumer Advocate of the terms of the security, describe the plant, property and/or equipment that is pledged as collateral on the debt instrument and provide a copy of the mortgage and encumbrance document, as required by HAR § 6-61-105(c)(2).

   B. As soon as reasonably practicable, HAWC shall file with the commission and Consumer Advocate information concerning the terms and conditions (e.g., amount of debt by type, interest rate on each type of debt, term of each type of debt, issuance costs, etc). In addition, if the spread between the interest rate of the debt issuance by AWCC and the U.S. Treasuries for comparable terms is greater than 200 basis points, AWCC, through HAWC shall provide information to support the higher interest rate.

   C. As soon as reasonably practicable, HAWC shall file with the commission and Consumer Advocate information concerning the nature of the utility assets that were acquired with the $5.9 million in funds referenced above.
2. Failure to comply with the requirements set forth herein, may constitute cause to void this Decision and Order, and may result in further regulatory action as authorized by law.

DONE at Honolulu, Hawaii SEP 18 2008.

PUBLIC UTILITIES COMMISSION
OF THE STATE OF HAWAII

By Carlito P. Caliboso, Chairman

By John E. Cole, Commissioner

By Leslie H. Kondo, Commissioner

APPROVED AS TO FORM:

Stacey Kawasaki Djou
Commission Counsel

2008-0035
CERTIFICATE OF SERVICE

The foregoing order was served on the date of filing by mail, postage prepaid and properly addressed to the following parties:

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