

BEFORE THE PUBLIC UTILITIES COMMISSION  
OF THE STATE OF HAWAII

In the Matter of the Application of)

CITIZENS COMMUNICATIONS COMPANY, )  
dba THE GAS COMPANY, K-1 USA )  
VENTURES, INC., and HAWAII GAS )  
COMPANY, L.L.C., nka THE GAS )  
COMPANY, LLC )

DOCKET NO. 03-0051

For Approval to Sell the Assets of )  
The Gas Company, and Other Related )  
Matters. )  
\_\_\_\_\_ )

DECISION AND ORDER NO. 20354

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DIV. OF CONSUMER AFFAIRS  
DEPT. OF LAND & NATURAL RESOURCES  
CONSUMER AFFAIRS  
STATE OF HAWAII

Filed July 25, 2003  
At 10:00 o'clock A.M.

Karen Higashi  
Chief Clerk of the Commission

ATTEST: A True Copy  
KAREN HIGASHI  
Chief Clerk, Public Utilities  
Commission, State of Hawaii.

K. Higashi

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On April 3, 2003, the commission approved and issued Stipulated Procedural Order No. 20107. Pursuant

thereto: (1) Applicants and the Consumer Advocate (collectively, the "Parties") held joint technical meetings; (2) the Consumer Advocate engaged in extensive discovery; and (3) Applicants submitted their responses to an array of information requests, including numerous supplemental filings and updates.

By Order No. 20285, filed on July 1, 2003, the commission approved the Parties' request to amend the procedural schedule by advancing the deadline dates to file their respective position statements. In compliance thereto: (1) on July 2, 2003, the Consumer Advocate filed its Position Statement; and (2) on July 3, 2003, Applicants filed their Reply Statement.<sup>1</sup>

On July 7 and 18, 2003, Applicants submitted additional, updated information. On July 22, 2003, the Consumer Advocate informed the commission that upon its review of this supplemental information, its overall recommendation, as set forth in its position statement, "has not changed."<sup>2</sup>

The Consumer Advocate recommends that the commission approve the joint application, subject to ten conditions. In response, Applicants: (1) state they understand the basis for the

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<sup>1</sup>The Parties' position statements are based on the information contained in the docket record as of June 30 and July 3, 2003, respectively. Given the nature of the subject transaction and proposed methods of financing, the docket record includes certain draft agreements and documents that Applicants intend to finalize upon the commission's approval (if granted) of the subject application.

<sup>2</sup>Throughout the course of this proceeding, Applicants have amended and updated their initial, joint application by their: (1) responses to the Consumer Advocate's information requests; and (2) Reply Statement. This decision and order is based on the evidence and information in the docket record as of July 22, 2003.



Consumer Advocate's concerns; (2) find that the proposed conditions are reasonable under the circumstances; and (3) do not object to the proposed conditions, without modification.

In the event the commission approves the joint application, Applicants are prepared to close the subject transaction by July 31, 2003.

## II.

### Seller

#### A.

#### Citizens Communications Company

Citizens Communications Company ("Citizens") is a publicly-traded Delaware corporation that provides telecommunications, electric, and gas utility services in 26 states. Citizens "has decided to concentrate on its telecommunications operations and is in the process of selling its [electric and gas] utility operations."<sup>3</sup>

#### B.

#### The Gas Company

The Gas Company ("TGC") is a duly franchised public utility, providing gas service throughout the State of Hawaii

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<sup>3</sup>Citizens previously provided electric utility service to the island of Kauai through its Kauai Electric Division. In Docket No. 02-0060, the commission approved Citizens' sale of Kauai Electric Division's assets to the Kauai Island Utility Cooperative. See Decision and Order No. 19755, filed on October 30, 2002; and Decision and Order No. 19658, filed on September 17, 2002. The sale ultimately closed "as of 12:01 a.m. on November 1, 2002."

(the "State").<sup>4</sup> TGC engages in both regulated and non-regulated gas utility operations, serving approximately 66,500 customers in the State. TGC, an operating division of Citizens, employs approximately 310 employees statewide.

TGC's regulated gas operations consist of the purchase, production, transmission, and distribution through gas pipelines, and sale for residential, commercial, and industrial uses of synthetic natural gas ("SNG") and liquid propane gas ("LPG"). TGC's non-regulated gas operations involve the purchase, distribution, and sale to residential, commercial, and industrial customers of tanked and bottled LPG.

TGC conducts both regulated and non-regulated gas operations on the islands of Oahu, Hawaii, Kauai, Maui, and Molokai, through its Honolulu, Hawaii, Maui, and Kauai gas

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<sup>4</sup>In particular, TGC holds a franchise granted by the State legislature to "manufacture and supply gas for use as a fuel, illuminating purposes and otherwise, throughout the State[.]" Act 262, Session Laws of Hawaii 1967.

Initially, the franchise for the manufacture and supply of gas was granted to Honolulu Gas Company in 1904. In 1971, the commission approved the reorganization and merger of Honolulu Gas Company with Gasco, Inc., a wholly-owned subsidiary of Pacific Resources ("PRI"), Inc. See Decision and Order No. 2762, filed on May 27, 1971, in Docket No. 1861, *In re Honolulu Gas Co. Ltd.*

In 1989, the commission approved the acquisition of PRI, Inc. by Broken Hill Proprietary Company, Limited, the parent company of BHP Hawaii Inc. See Decision and Order No. 10157, filed on March 9, 1989, in Docket No. 6386, *In re Gasco, Inc.* Thereafter, in 1997, the commission approved the acquisition and merger of Gasco, dba BHP Gas Company, with Citizens. See Decision and Order No. 15899, filed on September 10, 1997, in Docket No. 97-0035, *In re BHP Hawaii Inc.*

divisions.<sup>5</sup> On Lanai, TGC conducts only non-regulated gas operations.

TGC: (1) manufactures SNG at its plant in Campbell Industrial Park; and (2) provides SNG only to customers on the island of Oahu. The SNG is distributed directly from the plant through an underground utility system, serving businesses and residents from Kapolei to Hawaii Kai.

Customers served under TGC's regulated gas operations, but not served by the SNG utility system, are served by LPG, which is piped underground from a central storage site.<sup>6</sup> If pipeline service is unavailable for either SNG or LPG, customers are served through the delivery of LPG under TGC's non-regulated gas operations, in cylinders or tanks, directly to their businesses or homes.<sup>7</sup>

As of December 31, 2002, the book cost and original cost of TGC's regulated assets were \$98,480,905 and \$131,776,560, respectively.<sup>8</sup>

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<sup>5</sup>Utility gas operations on the island of Molokai are managed through TGC's Maui division.

<sup>6</sup>Customers not served by the SNG utility system are TGC's neighbor island customers and certain Oahu-based customers.

<sup>7</sup>In describing TGC and its operations, the commission takes administrative notice of: (1) its files in Docket No. 97-0035; and (2) the information contained in hawaiiigas.com, a website established and maintained by TGC. See Hawaii Administrative Rules § 6-61-48 (commission's official notice of certain facts) and Hawaii Rules of Evidence, Rule 201 (judicial notice of adjudicative facts). See also *Hendrickson v. eBay Inc.*, 165 F. Supp.2d 1082 (C.D. Cal. 2001)(judicial notice of descriptions and information from a website); and *Pollstar v. Gigmania Ltd.*, 170 F. Supp.2d 974 (E.D. Cal. 2000)(judicial notice of a printout from a website).

<sup>8</sup>Exhibit I of the joint application.

III.

Buyer

A.

The Gas Company, LLC

Hawaii Gas Company, L.L.C., nka The Gas Company, LLC ("TGC-LLC") is a Hawaii limited liability company formed in February 2003. TGC-LLC was formed for the purpose of: (1) acquiring certain assets and assuming certain liabilities of TGC; and (2) owning and operating TGC's regulated and non-regulated gas operations. A chart illustrating the upstream organization of TGC-LLC's parent entities, as described in sub-sections B to D, below, is attached as Exhibit F to the joint application.<sup>9</sup>

B.

HGC Holdings, L.L.C.

TGC-LLC's sole member is HGC Holdings, L.L.C. ("HGC Holdings"), a Hawaii limited liability company formed in February 2003. HGC Holdings was formed for the purpose of owning and holding the entire membership interest in TGC-LLC.

C.

HGC Managing Member, L.L.C., and K-1 HGC Investment, L.L.C.

HGC Holdings, in turn, consists of two members: (1) HGC Managing Member, L.L.C. ("HGC Managing Member"); and (2) K-1 HGC

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<sup>9</sup>This organizational chart is also attached as Exhibit 1 to this decision and order.

Investment, L.L.C. ("K-1 HGC Investment"). Both entities are Hawaii limited liability companies, formed in February 2003.

1. HGC Managing Member, L.L.C. and Roy A. Pickren, Jr.

HGC Managing Member was formed for the purpose of acquiring and holding the entire voting membership interest in HGC Holdings, which comprises 0.1 per cent of the company's total equity. HGC Managing Member will contribute approximately \$45,000 to HGC Holdings for the managing membership interest in HGC Holdings. Roy A. Pickren, Jr. is the sole member of HGC Managing Member.<sup>10</sup>

2. K-1 HGC Investment, L.L.C. and k1 Ventures Limited

K-1 HGC Investment is the only other member of HGC Holdings. K-1 HGC Investment was formed for the purpose of acquiring and holding the entire non-voting membership interest in HGC Holdings, which represents 99.9 per cent of HGC Holdings' total equity. K-1 HGC Investment will contribute approximately \$44,955,000 to HGC Holdings for its membership interest in HGC Holdings.

k1 Ventures Limited or a wholly-owned subsidiary, will be the sole member of K-1 HGC Investment.

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<sup>10</sup>Applicants explain that: (1) Mr. Pickren is the President and a principal of Crescent Technology, Inc., a professional consulting and engineering firm based in New Orleans, Louisiana; (2) Crescent Technology, Inc. undertook and completed the due diligence evaluation of TGC's assets prior to K-1 USA Ventures, Inc.'s execution of the Asset Purchase Agreement, which is described in Section IV.A and B of this decision and order; and (3) as a result of K-1 USA Ventures, Inc.'s experience with Crescent Technology, Inc., Mr. Pickren was selected as the managing member of HGC Holdings "after a careful review of his qualifications as well as the receipt of personal recommendations." See Applicants' responses to CA-IR-57 (Mr. Pickren's professional background) and CA-IR-71 (Crescent Technology, Inc.'s business profile).

D.

k1 Ventures Limited, K-1 Holdings Equity I, Inc.  
and K-1 USA Ventures, Inc.

k1 Ventures Limited is a Singapore company that is publicly-traded on the Singapore Exchange Securities Trading Limited. The principal activities of k1 Ventures Limited "are to invest in a wide range of investments across diverse industry sectors."<sup>11</sup> k1 Ventures Limited holds various investments in five countries, including the United States and Singapore. "It is anticipated that investments in the United States will continue to remain a key market" for k1 Ventures Limited.<sup>12</sup>

k1 Ventures Limited is the sole stockholder of K-1 Holdings Equity I, Inc., a Delaware corporation.<sup>13</sup> In turn, K-1 Holdings Equity I, Inc., is the sole stockholder of K-1 USA Ventures, Inc., a Delaware corporation.<sup>14</sup>

A chart illustrating the downstream organization of k1 Ventures Limited and its affiliate entities is attached as Exhibit F to the joint application.<sup>15</sup> In essence, K-1 USA Ventures, Inc. is a wholly-owned, indirect subsidiary of k1 Ventures Limited.

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<sup>11</sup>Applicants' response to CA-IR-9 (k1 Ventures Limited's 2002 Annual Report).

<sup>12</sup>Id.

<sup>13</sup>Exhibit F of the joint application.

<sup>14</sup>Id.

<sup>15</sup>This organizational chart is also attached as Exhibit 2 to this decision and order.

IV.

Asset Purchase Agreement and the Assignment Thereof

A.

The Gas Company, LLC: Buyer-Assignee

On December 19, 2002, Citizens and K-1 USA Ventures, Inc. entered into an Asset Purchase Agreement for the sale of TGC's assets. Thereafter: (1) on April 29, 2003, they executed a First Amendment to the Asset Purchase Agreement; and (2) on July 7, 2003, they executed a Second Amendment to the Asset Purchase Agreement.<sup>16</sup> Pursuant to section 6.8(f)(i) of the Agreement, as soon as reasonably practical following the commission's approval of the joint application, K-1 USA Ventures, Inc. will assign the Agreement to TGC-LLC. K-1 USA Ventures Inc. will undertake the assignment pursuant to an Assignment and Assumption Agreement executed with TGC-LLC.<sup>17</sup>

As such, K-1 USA Ventures, Inc. is referred to as the "Buyer" in the Agreement, while TGC-LLC is referred to as: (1) the "K1 Designee" in the Agreement; and (2) the "Buyer" in the joint application.

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<sup>16</sup>See enclosure to Applicants' letter, dated May 9, 2003, responding to the commission's request for clarifying information (First Amendment); and enclosure to Applicants' letter, dated July 7, 2003 (Second Amendment). Unless noted otherwise, the asset purchase agreement and amendments thereto are collectively referred to as the "Agreement."

<sup>17</sup>K-1 USA Ventures, Inc. remains as the "Buyer" until the effective date of the Agreement's assignment to TGC-LLC.

Upon the assignment: (1) TGC-LLC will assume, ratify, and agree to be bound by, and will perform all of the obligations of the buyer under the Agreement; and (2) all references in the Agreement and any ancillary agreements to "Buyer" shall "thereafter deemed to be references to the k1 Designee," i.e., TGC-LLC.

B.

Purchase and Sale

Citizens agrees to sell TGC's assets to TGC-LLC for a base purchase price of \$115 million, with TGC-LLC agreeing to assume TGC's liabilities.<sup>18</sup> In general, the sale includes the assets of TGC's operations used to manufacture, deliver, and sell regulated and non-regulated gas statewide, including TGC's SNG plant at Campbell Industrial Park and its related infrastructure.

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<sup>18</sup>The \$115 million purchase price represents a base figure that is subject to adjustment, plus or minus, pursuant to sections 3.3 and 3.4 of the Agreement.

Section 2.1 of the Agreement describes the subject "Assets" TGC-LLC will purchase upon closing, while section 2.2 lists the assets that are excluded from the sale, i.e., the "Excluded Assets."

In addition, section 2.3 describes the liabilities TGC-LLC agrees to assume upon closing, i.e., the "Assumed Liabilities." Conversely, section 2.4 lists the liabilities TGC-LLC will not assume upon closing, i.e., the "Excluded Liabilities."



The sale of TGC's assets is subject to certain conditions, including the commission's approval.<sup>19</sup>

Two investment banking firms have been retained as financial advisors: (1) Morgan Stanley & Co. Inc. for Citizens; and (2) Credit Suisse First Boston Corporation for K-1 USA Ventures, Inc. A competitive bidding process was used to arrive at the fair market value of TGC's assets.

C.

Limited Liability Company Operating Agreements

The Hawaii limited liability companies are organized pursuant to: (1) HRS chapter 428, the Uniform Limited Liability Company Act; and (2) the respective Limited Liability Company Operating Agreements ("Operating Agreement(s)"), which are attached to Applicants' supplemental response to CA-IR-13.<sup>20</sup> In summary, the Operating Agreements provide that:

1. TGC-LLC will be managed under HGC Holdings' direction.

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<sup>19</sup>See section 7.1(c) and (d) and section 7.2(c) of the Agreement. These sections provide that "Buyer shall have received all of Buyer's Required Regulatory Approvals by Final Order," and "Seller shall have received all of Seller's Required Regulatory Approvals by Final Order[.]" See also section 9.1(c) and (d) of the Agreement, governing the Agreement's termination in the event the "Required Regulatory Approvals" are denied.

Section 1.1 of the Agreement, in turn, defines "Required Regulatory Approvals" as including the commission's approval of the sale of TGC's assets, pursuant to HRS § 269-19. See also Schedules 4.3(b) and 5.3.(b) of the Agreement ("Seller Required Regulatory Approvals" and "Buyer Required Regulatory Approvals").

<sup>20</sup>The Operating Agreements are between: (1) HGC Holdings and TGC-LLC; (2) HGC Managing Member and K-1 HGC Investment; (3) HGC Managing Member and Roy A. Pickren, Jr.; and (4) K-1 HGC Investment and K1 Ventures Limited.

2. TGC-LLC's daily operations will be managed by or under the direction of its Board of Directors (Board). TGC-LLC's initial Board will consist of: (A) Roy A. Pickren, Jr., Chairman; (B) Jim R. Yates, TGC's Vice President; and (C) Timothy E. Johns, a Hawaii resident.<sup>21</sup>
3. The Board will also assist HGC Managing Member "in fulfilling its obligations" to HGC Holdings.
4. Immediately prior to or contemporaneously with the closing of the subject transaction, HGC Holdings shall make a contribution to TGC-LLC's capital in an amount equal to the purchase price required under the Agreement.

Upon the consummation of the subject transaction, TGC-LLC will pay the purchase price to Citizens.

5. Each of HGC Holdings' members may, from time-to-time, make additional capital contributions to HGC Holdings, as determined by HGC Managing Member.<sup>22</sup> The members' additional capital contributions, if made, shall be "in accordance with their respective Percentage Interests."
6. In turn, HGC Holdings may, from time-to-time and in its sole discretion, make additional contributions to TGC-LLC's capital "as particular capital needs arise."
7. Subject to certain exceptions specified in the applicable Operating Agreement, HGC Managing Member shall have: (A) sole and exclusive control over HGC Holdings; (B) the power and authority to take such actions it deems necessary or appropriate in connection with HGC Holdings' management and affairs; and (C) the authority to take all actions on behalf of HGC Holdings acting in HGC Holdings' capacity as the sole member of TGC-LLC.

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<sup>21</sup>For a discussion of Mr. Pickren's professional background, see footnote 10, above. Mr. Johns' resume is attached to Applicants' supplemental response to CA-IR-52e.

<sup>22</sup>The reasons for securing additional capital contributions include: (1) to conduct HGC Holdings' business, maintain its assets, and discharge its liabilities; and (2) to make capital contributions to TGC-LLC "for contingencies or emergency expenditures necessary to assure the ability of [TGC-LLC] to provide gas services to its customers[.]"

8. Except as otherwise provided, HGC Holdings' non-managing member, K-1 HGC Investment, will not have: (A) the obligation or the right to take part, directly or indirectly, in the active management or control of the business of HGC Holdings and K-1 HGC Investment; or (B) the right or authority to act or bind HGC Holdings.<sup>23</sup>
9. HGC Managing Member shall neither: (A) use HGC Holdings' assets for any purpose other than conducting HGC Holdings' business; nor (B) borrow any funds from HGC Holdings.
10. HGC Managing Member shall neither: (A) use TGC-LLC's assets for any purpose other than conducting TGC-LLC's business; nor (B) borrow any funds from TGC-LLC.

Applicants represent that TGC-LLC's ownership structure was "developed after consultation with special PUHCA counsel and the SEC staff," and "strictly follows prior positions taken by the SEC in other transactions." In addition: (1) "[n]o approval or other action by the SEC will be required under PUHCA for the

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<sup>23</sup>The applicable Operating Agreement provides that:

1. K-1 HGC Investment's prior written consent is required for HGC Holdings or TGC-LLC to enter into certain specified agreements.
2. Without K-1 HGC Investment's prior written consent, HGC Managing Member shall not take any action that would cause HGC Holdings, TGC-LLC, or any of its members or affiliates, "to become subject to regulation as a registered holding company" under the federal Public Utility Holding Company Act of 1935, as amended ("PUHCA").
3. Without K-1 HGC Investment's prior written consent, HGC Managing Member may not transfer all or any part of its interests in HGC Holdings.
4. HGC Managing Member may withdraw its membership in HGC Holdings upon K-1 HGC Investment's prior written consent.
5. After five years from the date of the Operating Agreement, K-1 HGC Investment shall have the right to require HGC Managing Member to conduct a public offering of HGC Holdings' or TGC-LLC's securities.

k1 Designee or any of its 'affiliates'" to consummate the subject transaction; and (2) K-1 USA Ventures, Inc. represents and warrants that it "obtained PUHCA Staff Concurrence regarding the proposed ownership, control and governance arrangements" of TGC-LLC.<sup>24</sup>

V.

Act 257, 1999 Session Laws of Hawaii

Act 257, 1999 Session Laws of Hawaii ("Act 257"), authorizes the issuance of special purpose revenue bonds by the State Department of Budget and Finance (the "Department"), totaling \$19.6 million, for TGC capital improvement projects relating to the furnishing of gas service.

Accordingly, by Decision and Order No. 17722, filed on May 9, 2000, in Docket No. 99-0350, the commission approved: (1) TGC's participation in the revenue bond financing authorized by Act 257; and (2) TGC's ability to borrow from the Department, up to \$19.6 million, "representing proceeds from the sale by the Department from time to time of special purpose revenue bonds authorized by Act 257[.]"

Pursuant to the Agreement and the IDRB Assumption Agreement, Citizens will allow HGC Holdings to assume the special purpose revenue bonds, provided that: (1) closing occurs on or prior to September 30, 2003; (2) HGC Holdings is able to satisfy all bond assumption conditions by closing; and (3) no intervening

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<sup>24</sup>See section 5.11 of the Agreement; and section 2 of the First Amendment to the Asset Purchase Agreement. "SEC" refers to the federal Securities and Exchange Commission.

market event requires Citizens to redeem the special purpose revenue bonds prior to closing. Applicants represent that the assumption "will occur simultaneously with the closing of the subject transaction, if approved."<sup>25</sup>

## VI.

### Capital and Financing

HGC Holdings will provide TGC-LLC the necessary funds to purchase TGC's assets through a capital contribution to TGC-LLC. Applicants state that:

1. The closing of the sale is not contingent upon HGC Holdings obtaining financing for any amount of the purchase price.
2. If HGC Holdings "decides not to obtain any financing, it is prepared and will have the financial ability to fund the entire amount of the purchase price through cash contributions from its members."

At the same time, HGC Holdings intends to obtain financing for a portion of the necessary funds. In this respect, HGC Holdings' proposed financing plan has fluctuated throughout

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<sup>25</sup>Applicants also explain that if HGC Holdings assumes the special purpose revenue bonds, then the base purchase price for TGC's assets will be reduced by \$17.6 million, the amount of the special purpose revenue bonds, from \$115 million to \$97.4 million. See Applicants' supplemental responses to CA-IR-22. This reduction, Applicants note, will not change the total amount of equity or debt associated with the subject transaction.

this proceeding.<sup>26</sup> Its current financing plan is attached as Exhibit A to Applicants' Reply Statement.<sup>27</sup>

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<sup>26</sup>For example, in its filings of June 5, 2003, Applicants describe two possible financing scenarios: (1) HGC Holdings' then preferred plan; and (2) HGC Holdings' alternative, worst case plan. (The June 5<sup>th</sup> filings include the (1) Financing Commitment Letter; (2) Engagement Letter; (3) draft Credit Agreement; (4) draft Pledge and Sharing Agreement; (5) draft Note Purchase Agreement; and (6) draft Pledge Agreement.)

Under HGC Holdings' then preferred financing plan, it intended to fund its contributions to TGC-LLC, as follows:

1. \$45 million in cash.
2. \$50 million term loan.
3. \$40 - \$45 million revolving line of credit.

Under HGC Holdings' then alternative financing plan, it intended to fund its contributions to TGC-LLC, as follows:

1. \$45 million in cash.
2. \$60 million term loan.
3. \$30 - \$35 million revolving line of credit.

The Consumer Advocate, in its Position Statement, examined: (1) these two plans; and (2) HGC Holdings' five-year financial projections under both plans. Subsequently, on July 3, 2003, the commission and Consumer Advocate were informed of HGC Holdings' current financing plan.

<sup>27</sup>As set forth in the joint application, HGC Holdings' primary plan was to fund its contributions to TGC-LLC, as follows:

1. \$45 million in cash.
2. \$75 million term loan.
3. \$15 million revolving line of credit.

The proposed financing terms subsequently changed, culminating in the proposed financing terms attached as Exhibit A to Applicants' Reply Statement. Applicants represent that "the currently expected financing interest rates are more favorable than that previously set forth as the 'worst case' scenario[.]" Applicants' Exhibit A is also attached as Exhibit 3 to this decision and order.

Under HGC Holdings' current financing plan, it intends to fund its contributions to TGC-LLC, as follows:

1. \$45 million in cash, received as capital contributions from its members, HGC Managing Member (\$45,000), and K-1 HGC Investment (\$44,955,000), respectively.
2. \$55 million term loan.
3. \$40 million revolving line of credit.

Banc of America Securities LLC will act as the sole and exclusive: (1) placement agent for the term loan; and (2) lead arranger and book manager for the revolving line of credit. Bank of America, N.A. will act as the sole and exclusive administrative agent for the revolving line of credit. Each financial institution reserves the right "to syndicate all or a part of [their] respective commitments to one or more financial institutions that will become Lenders or Note Purchasers, as the case may be."<sup>28</sup>

The final maturity dates for the term loan and revolving line of credit are not less than five years.<sup>29</sup> The

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<sup>28</sup>As stated in Applicants' supplemental response to CA-IR-71(b):

HGC Holdings expects the majority of the lenders in its \$40 - \$45 million bank facility to be local Hawaii financial institutions. Representatives of several local banks recently attended a bank meeting hosted by HGC Holdings and have expressed a strong interest in participating. The banks are currently seeking credit approval for this transaction.

<sup>29</sup>Exhibit A to Applicants' Reply Statement.

weighted average interest rates are at the London Interbank Offered Rate ("LIBOR"), plus a 2 per cent initial spread.<sup>30</sup>

HGC Holdings' current financing plan will also include:

(1) limitations on acquisitions, investments, mergers, and consolidations; (2) prohibitions on engaging in any business that will substantially change the general nature of TGC-LLC's business; (3) limitations on the incurrence and existence of indebtedness and liens; (4) limitations on the sale of TGC-LLC's assets; (5) prohibitions on transactions with affiliates that are not conducted on an arms-length basis; and (6) certain financial covenants.<sup>31</sup>

The financial covenants, in turn, "include certain provisions [to] assure that sufficient equity capital balances are accumulated." These covenants include: (1) requiring an initial minimum net worth of \$40 million, increasing annually by an amount equal to 50 per cent of each year's net income; (2) prohibiting the payment of dividends or the redemption of stock if the debt/capital ratio is greater than or equal to 60 per cent; and (3) requiring the maintenance of a debt/capital ratio of 67.5 per cent initially, with gradual step-downs over time.<sup>32</sup>

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<sup>30</sup>See Exhibit A to Applicants' Reply Statement; and Applicants' supplemental response to CA-IR-66 (Expected Financial Structure/HGC Holdings' Financial Projections, dated July 2003).

<sup>31</sup>See Exhibit A to Applicants' Reply Statement; and Applicants' responses to CA-IR-65 and CA-IR-70.

<sup>32</sup>See Exhibit A to Applicants' Reply Statement; and Applicants' response to CA-IR-65.



As explained in the joint application and Applicants' third supplemental response to CA-IR-22:<sup>33</sup>

1. The term loan (\$55 million) will be used to fund capital contributions to TGC-LLC. In turn, TGC-LLC will use these funds to acquire TGC's assets.

2. A portion of the proceeds from the revolving line of credit (\$25.4 million) will also be used to acquire TGC's assets. The remaining portion of the revolving line of credit (\$14.6 million) and all subsequent revolving disbursements thereto will be reserved exclusively to fund capital contributions to TGC-LLC for its use "for unexpected future capital expenditures for which internally generated funds are not available." Applicants state that the revolving line of credit "is intended to be utilized for unexpected capital expenditures only and not for working capital purposes."

HGC Holdings is the borrower and primary obligor under its current financing plan. TGC-LLC is required to provide a guaranty for the third-party financing arrangements, and HGC Holdings will pledge its membership interests in TGC-LLC as security for its financing arrangements. Thus, under this scenario, Applicants seek the commission's approval, pursuant to HRS § 269-17, of the guaranty and pledge, based on HGC Holdings

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<sup>33</sup>Applicants' joint application at 12; and Applicants' third supplemental response to CA-IR-22 (Capital Structure of HGC Holdings Estimated at Closing). Applicants' Capital Structure diagram is also attached as Exhibit 4 to this decision and order.

"obtaining financing arrangements at interest rates no higher than and in amounts and on terms substantially similar to those set forth in Exhibit A" of Applicants' Reply Statement.

In this respect, if the commission approves the joint application, Applicants propose to, promptly after the closing of the subject transaction, provide the commission and Consumer Advocate with "written notice of the approval of HGC Holdings' financing arrangements, the summary of the financing terms obtained, the financial closing of the subject transaction, and the status of the assumption of the special purpose revenue bonds by HGC Holdings."

Based on HGC Holdings' current financing plan, its latest five-year financial projections are attached to its supplemental response to CA-IR-66.

## VII.

### Transition to the New Ownership

Citizens and TGC-LLC have entered into a Transition Services Agreement "in order to bridge any gaps after closing and to ensure the smooth transition of services[.]"

Meanwhile, under TGC-LLC's subsequent ownership and operation, various administrative, oversight, and support services will be provided by: (1) TGC-LLC; (2) Crescent Technology, Inc. (3) HGC Holdings and its members; (4) McMoRan Exploration Company, a Delaware corporation engaged in the

exploration, development, and production of oil and gas;<sup>34</sup> and (5) various local service providers.<sup>35</sup> In various responses, Applicants represent that there should be no material cost differences and possibly some cost savings associated with the provision of these services by the affiliated entities.

#### VIII.

##### Applicants' Prayer for Relief

Applicants request commission action:

1. Approving, without modification, the Consumer Advocate's proposed conditions the commission finds "are reasonable and/or necessary under the circumstances."

2. Approving the sale of TGC's assets from Citizens to TGC-LLC, pursuant to HRS § 269-19.

3. Approving: (A) the Agreement; (B) K-1 USA Ventures, Inc.'s assignment of the Agreement to TGC-LLC; and (C) TGC-LLC's assumption of K-1 Ventures, Inc.'s obligations under the Agreement.

4. Approving the assignment of Citizens' TGC franchise to TGC-LLC, pursuant to HRS § 269-19.

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<sup>34</sup>See the attachment to Applicants' response to CA-IR-14 (McMoRan Exploration Company's 2002 annual report). McMoRan Exploration Company is a publicly-traded company. An affiliate of K1 Ventures Limited currently holds an investment interest in McMoRan Exploration Company. Its support staff is located in New Orleans, Louisiana.

<sup>35</sup>In addition to the Hawaii financial institutions that will fund the revolving line of credit, the local service providers will include: (1) Aon Risk Management Services; (2) Century Computers; (3) Communications Pacific; (4) Deloitte and Touche; and (5) First Hawaiian Bank.

5. Approving, pursuant to HRS § 269-17, TGC-LLC's guaranty of the loans proposed to be obtained by HGC Holdings, and the pledge by HGC Holdings of its membership interests in TGC-LLC as security for such loans, "at interest rates no higher than and in amounts and on terms substantially similar to those set forth in Exhibit A" attached to Applicants' Reply Statement.

6. Terminating certain regulatory conditions previously established by the commission in Decision and Order No. 15899, filed on September 10, 1997, in Docket No. 97-0035.

7. Terminating the condition imposed by Decision and Order No. 17722, filed on May 9, 2000, in Docket No. 99-0350, in the event the special purpose revenue bonds are not assumed by HGC Holdings.

8. Approving, pursuant to HRS § 269-17: (A) HGC Holdings' assumption of Citizens' special purpose revenue bonds issued for the purposes approved by the commission in Decision and Order No. 17722, and authorized by Act 257; and (B) TGC-LLC's joinder in the execution of the bond assumption documents.

9. Ruling that TGC's current commission-approved tariff shall continue in effect following closing, and that TGC-LLC shall republish the tariff in its own name "with the same rules, regulations, and rates[.]"

## IX.

### Consumer Advocate's Position: Overview

In this docket, the Consumer Advocate filed its position statement first, which was followed by Applicants' reply. The commission begins its analysis by reviewing the Consumer Advocate's position.

Following its extensive review, the Consumer Advocate finds that TGC's on-going business operations should be largely unaffected by its change in ownership, but that certain concerns associated with the subject transaction fall into three general categories: (1) financial security for the utility business; (2) future access to information required by regulators; and (3) ratemaking issues and near term rate increase risks arising from the subject transaction.

In general, "[n]ear term tangible risks and costs to ratepayers can be observed in connection with the incurrence of substantial transaction and transition costs, interest rate risks and related repayment guarantees and pledged utility ownership to secure parent company variable-rate debt, new complexities and costs associated with planned [TGC-LLC] affiliate transactions and the immediate loss of utility deferred tax reserves."

Ultimately, however, the Consumer Advocate concludes that these risks and costs are mitigated by the adoption of the

Consumer Advocate's ten recommended conditions. The Consumer Advocate's proposed conditions, verbatim, are:<sup>36</sup>

1. New TGC commits to not submitting any Application for a general utility rate increase that would utilize a prospective test year earlier than calendar 2007, unless the HPUC finds that a compelling financial need justifies the waiver of this condition.
2. None of the transaction and transition costs incurred by the Buyer and Seller shall be deferred as a regulatory asset for future recovery from ratepayers.
3. The debt to total capital ratio of HGC Holdings on a consolidated basis shall not exceed 65 per cent on and after December 31, 2004, calculated and reported on a quarterly basis, unless a higher debt ratio is requested by New TGC and is approved by the HPUC.

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<sup>36</sup>In the Consumer Advocate's description of its proposed conditions:

1. "Buyer" and "New TGC" refers to TGC-LLC;
2. "HPUC" refers to the commission;
3. "McMoRan" refers to McMoRan Exploration Company; and
5. "Seller" refers to Citizens.

Applicants state that their non-objection to the Consumer Advocate's proposed conditions is dependent upon the commission's adoption of said conditions without modification. In the event the commission modifies the language of the conditions, Applicants "respectfully request the opportunity to pursue any and all of their respective positions through further discussions and/or filings with the Commission and/or the Consumer Advocate." On July 22, 2003, the Consumer Advocate, with Applicants' concurrence, modified its proposed Condition No. 6.

This commission interprets Applicants' concurrence with the Consumer Advocate's proposed conditions without modification to mean that Applicants clearly understand the substance of each condition, and no clarification is necessary.

4. HGC Holdings will advise and inform the HPUC and Consumer Advocate about any proposed investment or acquisition transaction in excess of \$10 million that it is considering, no less than 30 days prior to closing, but in no event later than when the information becomes publicly available.

(The \$10 million represented approximately one year's worth of combined utility/non-utility CAPEX, which runs approximately \$10 - 12 million per year.)

5. HGC Holdings' membership interest in New TGC that is pledged to secure debt financing of HGC Holdings or the borrowings of any other affiliate shall not be transferable by creditors or their agents without application and approval by the HPUC.
6. New TGC will not object to consideration by the HPUC of debt and other capital balances and cost rates used to finance New TGC's utility business in any future rate case proceedings, based upon any argument that such debt or other capital was actually issued by HGC Holdings or another affiliate, rather than the regulated business entity, provided that such consideration does not preclude the consideration of other capital structures and rates, such as the hypothetical capital structures used in the past.
7. For a period of 48 months after closing the sale transaction, all recurring transactions between HGC Holdings, McMoRan or any affiliated entity (i.e., an entity with an "affiliated interest" with New TGC as defined in HRS § 269-19.5) with either New TGC or HGC Holdings will be documented by written contract and submitted to the HPUC and Consumer Advocate prior to the contract effective date, without regard to the expected annual transaction levels relative to the dollar thresholds codified in HRS § 269-19.5.
8. New TGC will provide a detailed reporting by entity of its transactions with HGC Holdings, McMoRan, and any affiliated entity (i.e., an entity with an "affiliated interest" with New TGC as defined in HRS § 269-19.5) by National Association of Regulatory Commissions ("NARUC") Account, type of service provided, and stating the basis of pricing for such services, as a supplement to New TGC's Annual Report to the HPUC for 2004 and all subsequent years.

9. HGC Holdings, McMoRan and all affiliated entities (i.e., an entity with an "affiliated interest" with New TGC as defined in HRS § 269-19.5) that provide services to the New TGC utility operation will provide complete access in Hawaii to all financial and operational data relevant in proceedings before the HPUC, upon the request of the HPUC or Consumer Advocate, provided that any such voluminous data that cannot reasonably be provided in Hawaii will be made available at other locations, with reimbursement by New TGC of any incremental costs caused by such out-of-state access.
10. If New TGC asserts income tax expenses for ratemaking purposes in any future rate case, the full benefits available to taxpaying affiliates of New TGC, that arise from New TGC's utility assets, operations and parent company interest deductions supportive of New TGC's utility assets, may be considered in ratemaking, without objection by New TGC based upon the utility not being the actual taxpaying entity.

In summary, the Consumer Advocate states that its proposed conditions "provide for accounting measures for transition and transaction costs consistent with Commission precedent, enhanced affiliated interest disclosures and other ratemaking commitments designed to protect customer interests." With these conditions, the Consumer Advocate concludes that:

- (1) TGC-LLC is fit, willing, and able to serve TGC's customers;
- (2) the subject transaction provides public interest benefits to the affected customers; and
- (3) the joint application should be approved.



X.

Fitness, Willingness, and Ability to  
Perform the Gas Utility Operations

The commission must first examine whether TGC-LLC is fit, willing, and able to operate as a public utility of gas service.<sup>37</sup>

Applicants state that TGC-LLC is fit, willing, and able to perform the services authorized by TGC's franchise, and to conform to the commission's applicable orders, rules, terms, and conditions. Specifically, Applicants contend:

1. HGC Holdings will provide the funds to purchase TGC's assets through a capital contribution to TGC-LLC.

2. TGC-LLC will have the financial fitness and ability to continue TGC's gas service operations through the

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<sup>37</sup>HRS § 269-7.5(a) provides that no public utility shall commence business in the State without first having obtained a certificate of convenience and necessity ("CPCN") from the commission. Pursuant to HRS § 269-7.5(b), a CPCN shall be issued if the holder "is fit, willing, and able properly to perform the service proposed and to conform to the terms, conditions, and rules adopted by the commission, and that the proposed service is, or will be, required by the present or future public convenience and necessity."

TGC holds a franchise to provide gas service throughout the State. As such, pursuant to HRS § 269-7.5(c), it is exempt from the requirement to obtain a CPCN under HRS § 269-7.5(a) and (b).

Nonetheless, the commission, in reviewing whether TGC-LLC is qualified to undertake TGC's utility operations, performs a similar analysis as that set forth in HRS § 269-7.5(b), governing CPCNs. See, e.g., Decision and Order No. 19658, filed on September 17, 2002, in Docket No. 02-0060, *In re Citizens Comm. Co, Kauai Elec. Div. and Kauai Island Util. Co-op*; and Order No. 15573, filed on May 8, 1997, in Docket No. 97-0035, *In re BHP Hawaii Inc., Gasco, Inc., and Citizens Util. Co.*

revenues generated from both the regulated and non-regulated sectors of such operations.<sup>38</sup>

3. TGC-LLC "will have adequate capital and other financial resources to perform its business operations and maintain its assets." Moreover, should the need arise in the future for additional equity capital, the members of HGC Holdings "will have the economic incentive to provide adequate funding in order to protect the long-term values of the investment." As Applicants explain, it is a primary objective of TGC-LLC and its owners "to maximize the value of the business and to ensure that adequate capital is made available to the business in order to achieve this objective."

4. TGC-LLC's willingness to assume the responsibilities of owning TGC's assets and operating the gas utility facilities "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."

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<sup>38</sup>Applicants note that because TGC-LLC is a newly-formed entity and does not presently own any assets or have any operations or income, TGC-LLC does not yet have an available balance sheet or income statement.

5. Pursuant to section 6.12 of the Agreement, TGC-LLC tendered offers of continued employment to all active TGC employees in the same or similar position.

All of TGC's senior management executives have accepted employment offers with TGC-LLC. These individuals include TGC's: (A) Vice President; (B) General Counsel; and (C) Directors of Accounting & Administration; Customer Affairs; External Affairs and Planning; Human Resources; Operations; and Sales, Marketing & Business Development. In addition, all of TGC's non-management employees have accepted employment offers with TGC-LLC.

Applicants, thus, represent that "all of TGC's existing employees have accepted offers of continued employment following [the] purchase of the TGC Assets."

6. TGC-LLC also agrees to assume TGC's existing collective bargaining agreement with the Hawaii Teamsters and Allied Workers Union Local 996.

7. TGC-LLC's retention of TGC's management team and employees will: (A) ensure the smooth transition of TGC's assets; and (B) enable TGC-LLC to retain such personnel's knowledge and experience in operating TGC.

8. Pursuant to section 6.19 of the Agreement, Applicants have formed a transition team for the purpose of preparing and implementing a transition plan to ensure a smooth transition from Citizens' ownership to that of TGC-LLC's.

9. In accordance with sections 2.1(f) and 2.3(h) of the Agreement, upon closing, TGC-LLC will assume all of the rights and obligations of TGC in connection with all applicable commission orders, rules, and other requirements.

10. TGC-LLC's principal place of business will remain at TGC's current principal place of business, 841 Bishop Street, Suite 1700, Honolulu, Hawaii.

As part of its extensive review, the Consumer Advocate examined: (1) TGC-LLC's operational fitness and ability to provide reliable gas service; (2) TGC-LLC's financial fitness to sustain the utility operations over the long-term; and (3) TGC-LLC's ability to access additional future capital. In this respect, the Consumer Advocate notes:

1. The retention of management and operating personnel is a critically important factor in assessing TGC-LLC's fitness and ability to operate the gas utility.

2. With Citizens' exit from the energy utility business in general and from all utility service businesses in the State, TGC-LLC must operate independently and autonomously.

3. In reviewing TGC-LLC's financial fitness, the Consumer Advocate examined: (A) the financial projections produced by Applicants; and (B) TGC-LLC's ability to "generate sufficient earnings to meet its debt service obligations, build equity, respond to anticipated costs, and generate sufficient

cash to pay for the operating expenses that will be incurred in the production and delivery of . . . gas service in the State."<sup>39</sup>

Upon its review, the Consumer Advocate finds that:

1. All of TGC's managerial employees have signed employment contracts with TGC-LLC, and all non-management employees have accepted offers of continued employment. Thus, by retaining all of TGC's current employees, TGC-LLC will have the technical and managerial expertise to perform the service of supplying and distributing the regulated and non-regulated gas service in the State.

2. To support the transition to TGC-LLC's independent operations at a reasonable cost, Citizens and TGC-LLC will enter into a Transition Services Agreement. Also, McMoRan Exploration Company, an entity that is loosely affiliated with k1 Ventures Limited, will provide certain administrative support services. Accordingly, based on the docket record, all reasonable steps have been taken to ensure the continuity of service to TGC-LLC's customers, "and it appears unlikely that the

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<sup>39</sup>The Consumer Advocate's findings and conclusions in this regard are based on its examination of: (1) HGC Holdings' then preferred and alternative plans; and (2) HGC Holdings' five-year financial projections under both plans. See footnote 26, above. The proposed financing terms subsequently changed, culminating in the proposed financing terms attached as Exhibit A to Applicants' Reply Statement. Applicants represent that "the currently expected financing interest rates are more favorable than that previously set forth as the 'worst case' scenario[.]" See footnote 27, above.

Upon review and comparison of HGC Holdings' then alternative plan with its current financing plan and related five-year financial projections, the commission concludes that the Consumer Advocate's applicable findings and conclusions remain largely unaffected.

transaction will cause a material detrimental impact upon utility service quality or reliability."

Concomitantly, the Consumer Advocate's Condition No. 1 "represents sufficient value to consumers to justify approval of the sale in spite of the near term operational risks of higher costs and uncertainties created by the transaction."

3. HGC Holdings' financial projections "illustrate that consistently positive free cash flows are anticipated from [TGC-LLC's] business under reasonable assumptions and at present utility tariff rate levels[.]" Since the financial health of TGC-LLC is apparent from the financial projections, TGC-LLC's financial fitness is most important in the context of: (A) how the purchase price is financed; and (B) whether future access to capital on reasonable terms is assured if TGC-LLC "experiences unexpected capital requirements due to uninsured casualty losses or other business reversals."

4. The \$115 million purchase price "represents a small discount from book value." New debt financing is proposed for all but \$45 million of the \$115 million purchase price.

5. HGC Holdings' financial projections of TGC-LLC's "cash flows for the next five years indicate that cash flows are expected to be adequate to meet debt service covenants." Specifically, under either the then preferred or alternative financing plans, "the projected available cash flows from the combined utility and non-utility business operations of [TGC-LLC] are consistently more than twice the debt service obligations associated with the planned parent company debt financing." If

HGC Holdings secures its preferred method of financing the acquisition, debt service will be "covered" three to four times with available cash flows.

6. The substantial projected positive cash flows from income and depreciation recoveries that are produced by TGC-LLC's utility and non-utility businesses "are expected to consistently exceed plant investment requirements and allow repayment of the debt, as well as growth in retained earnings." "These characteristics, combined with the front-loaded borrowing planned to finance the acquisition, suggest that the fairly modest financial risks surrounding debt service should be concentrated within the early years of new ownership." These are the years during which the proposed rate moratorium, Condition No. 1, "is important to protect ratepayers from any risks associated with [TGC-LLC's] financing decisions."

7. All of the planned debt financing is at floating short-term interest rates tied to the LIBOR, plus a spread above LIBOR. With projected initial borrowings of approximately \$80.4 million, the present low LIBOR interest rates of about 1.3 per cent "represent a compelling financial opportunity for [TGC-LLC] to leverage [its] income stream and maximize the after tax equity returns available to equity investors."<sup>40</sup>

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<sup>40</sup>The present LIBOR of 1.3 per cent is reflected in Applicants' third supplemental response to CA-IR-22, part 2.

8. In sum, HGC Holdings' financial projections support several conclusions:

(A) The consistently positive projected income and substantial cash flows at present utility base rate levels support the conclusion that the purchase price can be financed with either: (i) equity capital; or (ii) with the proposed debt financing, with a high degree of certainty regarding TGC-LLC's financial fitness.

(B) The planned debt financing enables TGC-LLC to leverage its income stream "to realize very attractive dividend and retained equity returns, which should reduce the need for future rate increases in the absence of major unanticipated utility cost increases, as long as the parent debt leverage can be recognized for ratemaking purposes."

(C) "[T]he planned debt financing contributes significant near term interest rate risk, because the financing is all variable rate short-term debt tied to LIBOR with the largest debt balances in the early years of ownership." This suggests that TGC-LLC's access to additional equity capital may be important to its future financial flexibility and that "a rate case moratorium is valuable to TGC's utility consumers as a way to insulate [TGC-LLC's] consumers from interest rate risks arising from" HGC Holdings' planned acquisition borrowings.

9. A portion of the revolving line of credit is available to meet TGC-LLC's unanticipated financial needs. HGC Holdings' financial projections indicate a gradual increase in the unused portion of the line of credit. TGC-LLC also expects



to rapidly accumulate equity capital and improve its equity ratio through the retention of earnings and the repayment of debt, "which will serve to improve future access to debt capital." "This internal buildup of equity is important because it improves the access to additional debt financing and because there is an opportunity, but no obligation on the part of equity investors, to infuse new equity capital into the business."

Based on the foregoing reasons, the Consumer Advocate concludes that: (1) with the commission's approval of Condition Nos. 1, 3, and 4, TGC-LLC is fit and able to own and operate the gas utility; and (2) with these three conditions, "the transaction of proposed financing arrangements represent adequate financial resources and the reasonable ongoing access to additional capital that may be required" by HGC-LLC.

Upon thorough review, the commission: (1) will impose as reasonable the conditions agreed to by the parties (Condition Nos. 1, 3, and 4); and (2) finds that TGC-LLC is fit, willing, and able to operate as a public utility of gas service.

## XI.

### Sale of The Gas Company's Assets

HRS § 269-19 provides that "[n]o 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, . . . without first having secured from the public utilities commission an order

authorizing it so to do." The purpose of HRS § 269-19 is to safeguard the public interest. *In re Honolulu Rapid Transit Co., Ltd.*, 54 Haw. 402 (1973).<sup>41</sup>

Applicants seek commission action approving: (1) the sale of TGC's assets from Citizens to TGC-LLC, pursuant to HRS § 269-19; (2) the assignment of the Agreement to TGC-LLC; and (3) TGC-LLC's assumption of K-1 USA Ventures, Inc.'s obligations under the Agreement. In support thereto, Applicants state:

1. Consistent with the regulatory treatment for the premium paid by Citizens when it acquired TGC, any acquisition premium/discount in this transaction will be recorded on the non-regulated operations in the same manner. TGC-LLC will not attempt to recognize or seek regulatory recognition of any acquisition premium/discount through the utility's regulated rates.

2. None of the transaction and transition costs are being deferred or capitalized on TGC's books for recovery in future rate cases.

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<sup>41</sup>See also Decision and Order No. 19658, filed on September 17, 2002, in Docket No. 02-0060, *In re Citizens Comm. Co., Kauai Elec. Div. and Kauai Island Util. Co-op* (reasonable and consistent with the public interest); and Order No. 15573, filed on May 8, 1997, in Docket No. 97-0035, *In re BHP Hawaii Inc., Gasco, Inc., and Citizens Util. Co.* (protection of the public interest).

3. Applicants have not formally proposed any ratemaking adjustments at present and have no current plans to do so. They believe that any such adjustments are neither reasonable nor appropriate at this time.<sup>42</sup>

4. All of TGC-LLC's books and records will be maintained in the State. TGC-LLC's financial records will be maintained in accordance with generally accepted accounting principles, aka GAAP, and the commission's applicable orders, rules, and other requirements.

In examining whether the public interest is protected by the subject transaction, the Consumer Advocate focused on the potential benefits, risks, and costs of the subject transaction to the customers of TGC-LLC's utility operations. Ultimately, the Consumer Advocate recommends that the sale of TGC's assets from Citizens to TGC-LLC be approved, subject to the commission's adoption of its proposed conditions.

In this respect, the Consumer Advocate explains:

1. Condition Nos. 1 and 2: Applicants will incur more than \$6 million in transaction, financing, and transaction costs in connection with the subject transaction. The commission has

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<sup>42</sup>Applicants explain that: (1) TGC-LLC will receive an equity contribution from HGC Holdings for 100 per cent of the cash required to complete the subject transaction; thus (2) TGC-LLC's capital structure will be 100 per cent equity. Accordingly, they surmise that a hypothetical capital structure will "probably be used for ratemaking purposes." Nonetheless, Applicants acknowledge that the commission "will ultimately decide the appropriate capital structure and costs to apply[]" for future ratemaking purposes.

adopted a policy in prior utility acquisition and sales transactions "of not allowing transaction and transition costs to be charged to the utility's customers." Hence, the Consumer Advocate's proposed Condition No. 2 "precludes the deferral of any transaction or transition costs . . . to prevent cost shifting into future test years[.]"

Also, its proposed rate case moratorium, Condition No. 1, "ensure[s] that any early rate case is not used to seek improper recovery of such costs from ratepayers during the transition period when such costs are being incurred (and expensed)."

2. Condition Nos. 3, 4, 5, and 6: The loan guarantee by TGC-LLC and the pledge of HGC Holdings' membership interest in TGC-LLC "cause this financing to be of direct importance to the utility and its ratepayers." As a result, "conditions are needed to insulate the utility and its ratepayers from the risks associated with the parent company debt guarantee and the pledge of membership interests to secure the parent's loans."

Specifically, "[l]imitations on future debt, to not exceed 65 per cent of consolidated HGC Holdings' capitalization are proposed by the Consumer Advocate (Consumer Advocate Condition No. 3) and a notice requirement is recommended to protect against HGC Holdings making significant new diversified investments without Commission awareness (Consumer Advocate No. 4)."

Furthermore, with respect to the pledge of HGC Holdings' membership interest in TGC-LLC, the Consumer Advocate proposes a formal condition, Condition No. 5, which prevents the transfer of TGC-LLC's ownership without the commission's review and approval.

In addition, "[u]sing the actual planned utility entity capital structure of 100 per cent equity in future cases would clearly be unfair to ratepayers because of the higher cost rate associated with equity and the absence of income tax deductions for debt interest." Instead, the commission should be free to consider TGC-LLC's actual capitalization, including any actual debt at the parent level, "as well as other hypothetically optimal or more balanced capital structures in future rate cases." Accordingly, the Consumer Advocate "recommends a condition that obligates [TGC-LLC] to not object to ratemaking consideration of actual parent company debt capital balances and debt cost rates in future rate proceedings (Consumer Advocate Condition No. 6)."

3. Condition Nos. 7, 8, and 9: "[M]ultiple new affiliates and other associated companies in diverse locations now appear poised to charge or allocate administrative and 'oversight' costs to [TGC-LLC's] regulated operations on a continuing basis[.]" Certain conditions proposed by the Consumer Advocate "should have the effect of mitigating the risks associated with inappropriate affiliate relationships and transactions."

In particular, it recommends "conditions to strengthen the regulatory disclosures under HRS § 269-19.5 surrounding new affiliate transactions for TGC, by requiring for the next four years the submission of written contracts for all new ongoing affiliate and associated company transactions to the Commission and Consumer Advocate, regardless of the anticipated dollar amounts to be transacted (Consumer Advocate Condition No. 7), supplemental reporting of certain affiliate and other defined transactions in [TGC-LLC's] Annual Report to the [commission] (Consumer Advocate Condition No. 8) and reasonable regulatory access to the books and records of all affiliates and other associated entities (Consumer Advocate Condition No. 9)."

4. Condition Nos. 1 and 10: "Income tax expenses will continue to be included in [TGC-LLC's] utility revenue requirements, even though parent/member entities represent the actual taxpayers that will benefit from accelerated depreciation, debt interest deductions and any other tax preference items. Existing deferred income tax reserves that are related to TGC utility property will be lost upon [the] sale by Citizens and will only be gradually rebuilt within the books of the HGC Holdings' parent company, causing an immediate increase in [TGC-LLC's] revenue requirements in any near-term rate case proceeding."

Thus, two conditions "are necessary to protect ratepayers from the adverse income tax related cost impacts."

"First, the rate case moratorium is needed to provide for a period during which new deferred tax reserves are being rebuilt on HGC Holdings' books to replace the reserves that no longer exist on TGC books after the sale (Consumer Advocate Condition No. 1). Second, a requirement that all tax deduction benefits available to taxpaying affiliates of HGC [Holdings] arising from utility assets, operations and parent company interest deductions may be considered in ratemaking, without an objection that is based upon an argument that the utility is not the actual taxpaying entity is needed (Consumer Advocate Condition No. 10)."

The commission finds that Citizens, as part of its corporate plan, is phasing out its electric and gas utility operations, and has contracted with an interested buyer that is fit, willing, and able to assume TGC's utility operations. TGC-LLC will: (1) own and operate the gas utility with the same management and personnel, and TGC's existing facilities and related infrastructure; (2) continue to provide uninterrupted service to TGC's customers at the same tariff rates, terms, and conditions of service; and (3) conform to the commission's applicable orders, rules, terms, and conditions of gas utility service.

Moreover, there appears no evidence in the docket record showing that the utility operations will be adversely affected.<sup>43</sup>

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<sup>43</sup>As the Consumer Advocate concludes, in part: "[T]he ongoing business operations of TGC should be largely unaffected by the change in ownership[.]"

Upon thorough review, the commission: (1) will adopt as reasonable the additional conditions agreed to by the parties (Condition Nos. 2, 5, 6, 7, 8, 9, and 10); and (2) finds that the sale of assets from Citizens to TGC-LLC is consistent with the public interest. Accordingly, the commission will approve the sale, the assignment of the Agreement to TGC-LLC, and TGC-LLC's assumption of K-1 USA Ventures, Inc.'s obligations under the Agreement.

## XII.

### Assignment of the Gas Utility Franchise

HRS § 269-19 prohibits the assignment of any utility franchise "without first having secured from the public utilities commission an order authorizing it so to do."

Applicants request the commission's approval to assign Citizens' TGC franchise to TGC-LLC. Subject to its proposed conditions, the Consumer Advocate does not object to said assignment.

Consistent with Sections X and XI, above, the commission will approve the assignment of Citizens' TGC franchise to TGC-LLC.

## XIII.

### Guaranty and Pledge

HRS § 269-17 authorizes a public utility corporation, upon the commission's approval, to issue stocks, bonds, notes, and other evidences of indebtedness, "payable at periods of more



than twelve months after the date thereof," for the following purposes and no other:

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

"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 the securities. On the other hand, purposes 3 and 4 relate to the past expenditures 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."<sup>44</sup>

Applicants seek the commission's approval of TGC-LLC's guaranty of the loans proposed to be obtained by HGC Holdings, and the pledge by HGC Holdings of its membership interests in TGC-LLC as security for such loans, "at interest rates no higher than and in amounts and on terms substantially similar to those set forth in Exhibit A" of Applicants' Reply Statement.

In its analysis, the commission views TGC-LLC and HGC Holdings as a "public utility corporation" under HRS § 269-17. Upon review, the commission finds that the guaranty and pledge,

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<sup>44</sup>Decision and Order No. 16340, filed on May 21, 1998, at 5, in Docket No. 98-0090, *In re Waikoloa Resort Util., Inc., dba West Hawaii Util. Co.*

as described in the financing documents, are for purposes permitted by HRS § 269-17.

XIV.

Declaratory Ruling - Docket No. 97-0035

Applicants seek an order terminating certain conditions set forth in Decision and Order No. 15899, filed on September 10, 1997, in Docket No. 97-0035.

By Decision and Order No. 15899, the commission approved: (1) Citizens' purchase of all the outstanding stock of Gasco, Inc., from BHP Hawaii Inc.; (2) the merger of Gasco, Inc., into Citizens; and (3) the resulting formation of TGC as an operating division of Citizens. Decision and Order No. 15899, Section VIII(1), also imposed certain regulatory conditions upon Citizens and TGC.<sup>45</sup>

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<sup>45</sup>Specifically, subsections a to g, as follows:

a. Citizens shall designate and retain in the State of Hawaii an employee who shall be authorized to accept service of and execute the orders and directives of the commission. The commission shall be provided with the name and address of such person at all times.

b. Citizens shall maintain a complete and separate set of financial records relating to the operations of Gasco in accordance with generally accepted accounting principles and with the commission's orders, rules, and regulations.

c. Citizens and Gasco Division shall record all transaction and implementation costs associated with the acquisition and merger of Gasco with Citizens until Gasco Division's next rate case. Citizens and Gasco Division shall file with the commission a report of such costs in Gasco Division's next rate case.

d. Citizens shall make its books, accounts, files, and records available for audit or examination by the commission and Consumer Advocate. If such audit or examination must be

Applicants seek an order terminating the regulatory conditions set forth in Decision and Order No. 15899, Section VIII(1). Applicants state that the subject conditions were imposed because: (1) Citizens is not a Hawaii-based entity; (2) Gasco, Inc. merged into Citizens; (3) Citizens formed TGC as a separate, operating division; and (4) Citizens' ownership, at the time of the merger, of both the franchised electric and gas utilities on the island of Kauai.

Applicants contend that the subject conditions are specific to Citizens. Thus, upon the acquisition and sale of TGC to TGC-LLC, a Hawaii-based entity, the subject conditions will be

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made outside the State, Citizens shall reimburse the commission and the Consumer Advocate for the actual expenses incurred in connection with the audit or examination, including traveling and hotel expenses and consultants' fees.

e. Gasco Division shall (1) maintain its residential retail price of bottled gas on Kauai at the Maui price until Gasco Division can demonstrate that viable competition in the retail residential sale of bottled gas exists on Kauai; (2) so long as effective competition in the retail sale of bottled gas on Kauai fails to manifest itself in another form, sell bottled gas at wholesale, on a nondiscriminatory basis, to marketers who may wish to engage in the retail sale of bottled gas on Kauai, at a rate not greater than the rate Gasco Division charges itself in pricing its retail sale of bottled gas on Kauai; and (3) negotiate prices and service terms with customers on Kauai who may wish to aggregate their demands and purchase bottled gas in large volumes.

f. Any cost savings resulting from the economies of scale on Kauai created by the acquisition and merger shall be passed on by Gasco Division to its ratepayers on Kauai in the context of Gasco Division's future rate cases.

g. Citizens may consolidate for the island of Kauai Gasco Division's and Kauai Electric's [Integrated Resource Plans] in Kauai Electric's current planning cycle.

rendered inapplicable or moot. Applicants state that: (1) separate financial records by Citizens for TGC will no longer be required because the TGC assets will be owned and operated by TGC-LLC, a Hawaii-based company with no other assets or operations; and (2) the 1997 merger will no longer have any impact on TGC's ratepayers once TGC-LLC purchases and acquires TGC's assets.

The Consumer Advocate concurs that there is no continuing need for five of the seven conditions, specifically, subsections a, b, e, f, and g. In addition, the Consumer Advocate notes that its proposed Condition Nos. 2 and 9 effectively supersede the remaining two conditions, subsections c and d.

Upon review, the commission finds that the acquisition and sale of TGC to TGC-LLC renders inapplicable or moot the regulatory conditions set forth in Decision and Order No. 15899, Section VIII(1). At the same time, the commission will impose certain new, superseding conditions applicable to TGC-LLC, including the Parties' agreed upon Condition Nos. 1 and 9. See Section XVII, below.

#### XV.

##### Special Purpose Revenue Bonds

##### A.

##### Annual Report

Decision and Order No. 17722, Section III(11), filed on May 9, 2000, in Docket No. 99-0350, requires TGC to file, by

March 31<sup>st</sup> of each year, an annual report describing "the progress made, under Act 257, in reducing [TGC's] financing costs."

The Parties agree that in the event the special purpose revenue bonds are assumed by HGC Holdings, the annual reporting condition should continue as an on-going obligation imposed upon TGC-LLC. Conversely, in the unlikely event that the special purpose revenue bonds are not assumed by HGC Holdings, Applicants seek an order terminating the annual reporting condition.

Upon review, the commission finds that Applicants' request for a declaratory ruling, in this instance, is not yet ripe. Specifically, Applicants fully describe their intentions to meet the necessary conditions to allow HGC Holdings to assume the special purpose revenue bonds. Thus, if and when HGC Holdings does not assume the bonds, at that time, Applicants can seek the appropriate relief with this commission.

B.

Assumption and Joinder

In their Reply Statement, Applicants, for the first time, note that if the special purpose revenue bonds are assumed by HGC Holdings, TGC-LLC must join in the execution of the bond assumption documents for the purpose of agreeing to perform the covenants applicable to TGC-LLC. Applicants state their intent to submit to the commission and Consumer Advocate the bond assumption documents, "once they are received and finalized."

Accordingly, Applicants seek the commission's approval, pursuant to HRS § 269-17: (1) of HGC Holdings' assumption of

Citizens' special purpose revenue bonds; and (2) TGC-LLC's joinder in the execution of the bond assumption documents.

As previously stated, the commission views TGC-LLC and HGC Holdings as a "public utility corporation" under HRS § 269-17. Upon review, the commission finds that the assumption and joinder, as described in Applicants' Reply Statement, are for purposes permitted under HRS § 269-17.

#### XVI.

##### Ultimate Findings of Fact and Conclusions of Law

Based on the foregoing, the commission makes the following ultimate findings of fact and conclusions of law:

1. The ten conditions agreed upon by the Parties, as proposed by the Consumer Advocate, are reasonable. Accordingly, the sale of assets from Citizens to TGC-LLC is reasonable and consistent with the public interest.

2. TGC-LLC is fit, willing, and able to operate as a public utility of gas service.

3. The assignment of Citizens' TGC franchise to TGC-LLC is consistent with HRS § 269-19.

4. The guaranty and pledge, as described in the financing documents, are for purposes permitted by HRS § 269-17.

5. The acquisition and sale of TGC to TGC-LLC renders inapplicable or moot the regulatory conditions set forth in Decision and Order No. 15899, Section VIII(1).

6. The assumption and joinder, as described in Applicants' Reply Statement, are for purposes permitted under HRS § 269-17.

7. TGC's current commission-approved tariff, is just and reasonable.

#### XVII.

##### THE COMMISSION ORDERS:

1. In accordance with HRS § 269-19, the sale of TGC's assets from Citizens to TGC-LLC is approved, subject to the following terms and conditions:

A. The Parties' agreed upon conditions, as set forth in Section IX of this decision and order.

B. Promptly after the closing of the subject transaction, Applicants shall provide the commission and Consumer Advocate with written notice of the approval of HGC Holdings' financing arrangements, the summary of the financing terms obtained, the financial closing of the subject transaction, and the status of the assumption of the special purpose revenue bonds by HGC Holdings.

C. Promptly after the closing of the subject transaction, TGC-LLC shall file its initial tariff with the commission, incorporating the same rules, regulations, and rates as set forth in TGC's current commission-approved tariff.

D. Promptly after the closing of the subject transaction, TGC-LLC shall provide written notice to its customers of the sale and change in ownership and operation of

TGC. TGC-LLC shall provide copies of its written notice to the commission and Consumer Advocate.

2. K-1 USA Ventures, Inc.'s assignment of the Agreement to TGC-LLC, and TGC-LLC's assumption of K-1 Ventures Inc.'s obligations under the Agreement, are approved.

3. The assignment of Citizens' TGC franchise to TGC-LLC is approved, pursuant to HRS § 269-19.

4. TGC-LLC's guaranty of the loans proposed to be obtained by HGC Holdings, and the pledge by HGC Holdings of its membership interests in TGC-LLC as security for such loans, "at interest rates no higher than and in amounts and on terms substantially similar to those set forth in Exhibit A" of Applicants' Reply Statement, are for purposes permitted by HRS § 269-17.

5. Upon the closing of the subject transaction, the regulatory conditions set forth in Decision and Order No. 15899, Section VIII(1), are terminated.

6. HGC Holdings' assumption of Citizens' special purpose revenue bonds issued for the purposes approved by the commission in Decision and Order No. 17722, as authorized by Act 257, and TGC-LLC's joinder in the execution of the bond assumption documents, are for purposes permitted by HRS § 269-17.

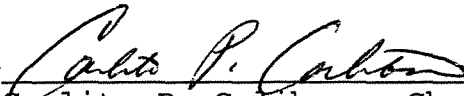
7. The commission's other applicable orders, rules, terms and conditions, not terminated by this decision and order, shall continue in effect, as applied to TGC-LLC, including the: (A) monthly rate of return report; (B) annual financial report; and (C) public utility fee.

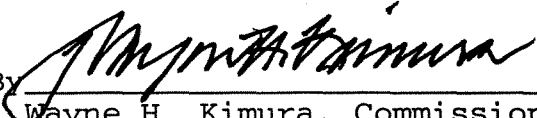


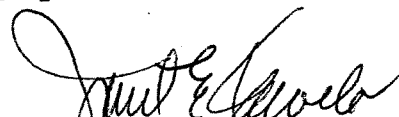
8. TGC-LLC shall file by January 31<sup>st</sup> of the following year, an annual report covering the previous calendar year period, describing the support service agreements or contracts of TGC-LLC or HGC Holdings, and the amounts expended thereto. The commission, at its option and consistent with HRS § 269-8, may require that TGC-LLC file copies of any agreements or contracts with the commission. The first annual report shall be due no later than January 31, 2004. Copies of the annual report shall be served upon the Consumer Advocate.

DONE at Honolulu, Hawaii this 25th day of July, 2003.


PUBLIC UTILITIES COMMISSION  
OF THE STATE OF HAWAII

By   
Carlito P. Caliboso, Chairman

By   
Wayne H. Kimura, Commissioner

By   
Janet E. Kawelo, Commissioner

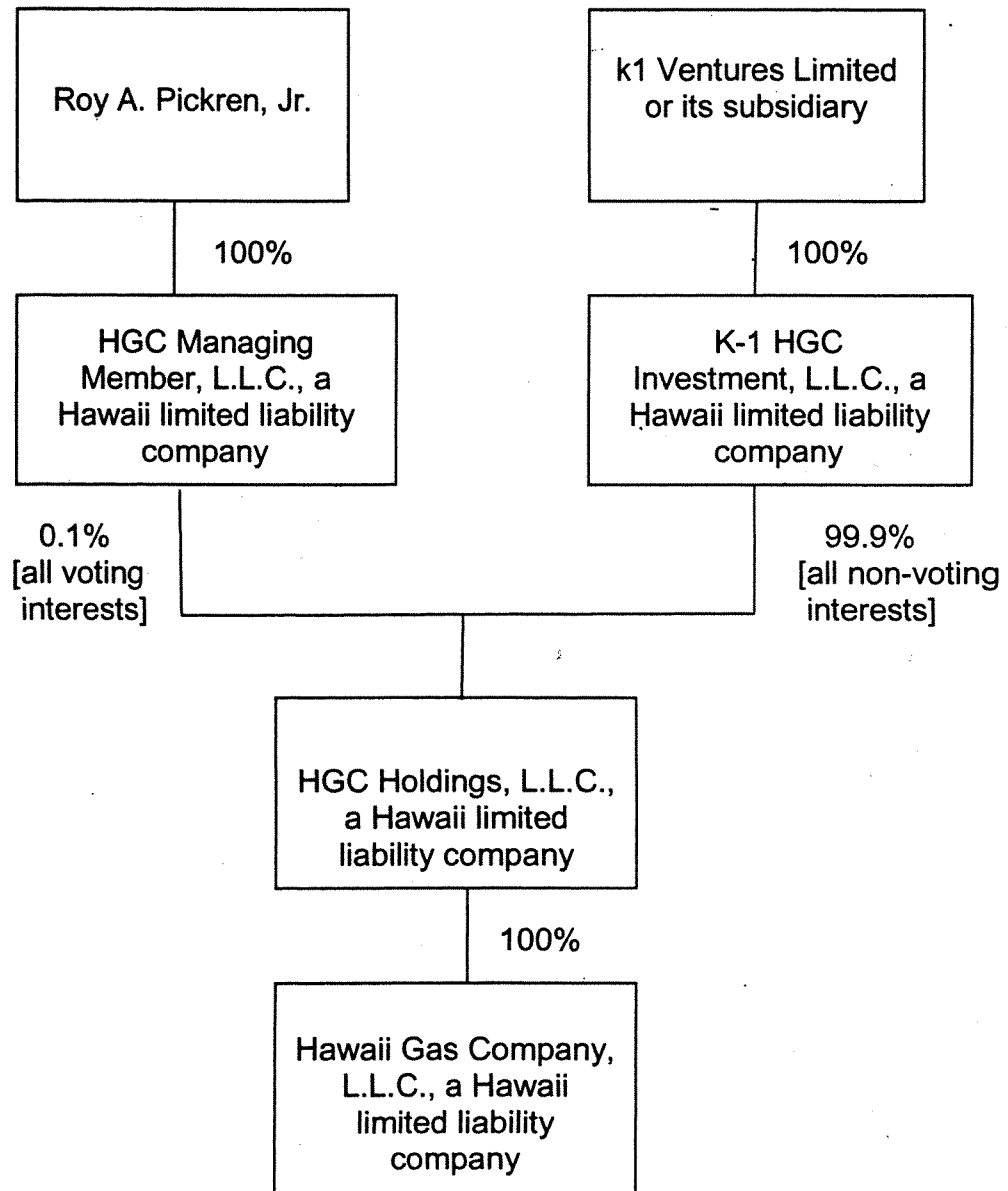
APPROVED AS TO FORM:

  
Michael Azama  
Commission Counsel

03-0051DO.sl

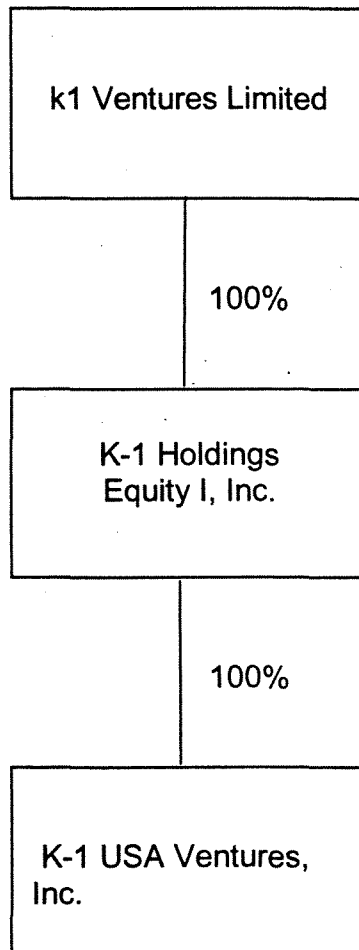
## Organizational Chart

### Buyer



## Organizational Chart

### K-1 USA



# Expected Financing Terms

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**Borrower:** HGC Holdings, LLC

**Guarantor:** The Gas Company, LLC

**Amount:** \$95 Million\*

**Use of Proceeds:** Acquisition of The Gas Company Division of Citizens Communications Company, capital expenditures and other corporate purposes

**Final Maturity:** No less than 5 years

**Weighted Average Interest Rates:** LIBOR + 2.00%

\* To include a combination of notes issued through private placement (anticipated to be \$55 million), bank revolver (anticipated to be \$40 million, including credit support facility for potential assumption of SPRBs).

# **Expected Financing Terms**

## **(continued)**

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***Security:*** Pledge of Membership Interests in The Gas Company, LLC

***Covenants:*** Limitations on liens; mergers and consolidations; asset sales > 10% of total assets; debt; dividends and stock redemptions unless Debt/Capital Ratio < 60% and may not exceed 100% of Excess Cash Flow until Debt/Capital < 55%; redemption of debt; investments; transactions with affiliates.

***Financial Covenants:***

- ◆ Minimum Net Worth Requirement
- ◆ Maximum Debt/Capital Ratio
- ◆ Minimum Fixed Charge Coverage Ratio

Capital Structure of HGC Holdings  
Estimated at Closing  
With or Without the SPRBs

	With Assumption	W/O Assumption
SPRBs	\$ 17.6	\$ -
Funding from Notes	55.0	55.0
Funding from \$40mm Revolver	<u>7.8</u>	<u>25.4</u>
Total Debt	\$ 80.4	\$ 80.4
Total Equity	<u>45.0</u>	<u>45.0</u>
Total Purchase Price, Incl Est. Exp.(1)	\$ 125.4	\$ 125.4
Revolver Availability @ Closing (\$40mm commitment) (2)	14.6	14.6

(1) Purchase Price Including Bond Assumption

Base Purch Price	\$ 97.4
Assumption of Bonds	17.6
Adj for Working Capital (Pro forma 12/31/02)	3.9
Estimated Fees and Expenses (3)	<u>6.5</u>
	\$ 125.4

(2) Since letters of credit issued under the Revolving Credit Facilities are counted as usage, the availability under the Revolver at closing would not be materially affected.

(3) Preliminary estimate used for planning purposes

CERTIFICATE OF SERVICE

I hereby certify that I have this date served a copy of the foregoing Decision and Order No. 20354 upon the following parties, by causing a copy hereof to be mailed, postage prepaid, and properly addressed to each such party.

DEPARTMENT OF COMMERCE AND CONSUMER AFFAIRS  
DIVISION OF CONSUMER ADVOCACY  
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nka THE GAS COMPANY, LLC  
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CERTIFICATE OF SERVICE - Continued

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nka THE GAS COMPANY, LLC

  
\_\_\_\_\_  
Karen Higashi

DATED: July 25, 2003