

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF HAWAII

In the Matter of the Application of)
HAWAII WATER SERVICE COMPANY, INC.)
For Approval of Rate Increases and)
Revised Rate Schedules, and to)
Enter into Financing Arrangements.)
_____)

DOCKET NO. 03-0275

DECISION AND ORDER NO. 21211

Filed August 5, 2004
At 8 o'clock A.M.

Karen Higashi
Chief Clerk of the Commission

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K. Higashi

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DECISION AND ORDER

I.

Background

HAWAII WATER SERVICE COMPANY, INC. ("HWSCI" or "HWSC"), fka KAA NAPALI WATER CORPORATION, is a public utility that provides water service in its service area of Kaanapali, island of Maui, pursuant to a commission-issued certificate of public convenience and necessity.¹ HWSCI, a Hawaii corporation, is a wholly-owned subsidiary of California Water Service Group ("CWSG"), a holding company incorporated in Delaware. Besides HWSCI, CWSG's operating subsidiaries include California Water Service Company (water service), New Mexico Water Service Company (water and wastewater services), and Washington Water Service Company (water service).

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

HWSCI requests the commission's approval to engage in certain financing, pursuant to Hawaii Revised Statutes ("HRS") §§ 269-17 and 269-19.² HWSCI served copies of its application, as amended, upon the Department of Commerce and Consumer Affairs, Division of Consumer Advocacy ("Consumer Advocate") (collectively, the "Parties").

On May 18 and June 9, 2004, HWSCI responded to the Consumer Advocate's information requests. The Consumer Advocate does not object to HWSCI's financing request, subject to certain conditions.³ HWSCI did not respond to the Consumer Advocate's position statement.⁴ Instead, on July 16, 2004, HWSCI informed the commission that the Parties agree that HWSCI's financing request is ready for decision-making by the commission.⁵

The commission, in response to HWSCI's request, bifurcated HWSCI's financing request from its request for a general rate increase utilizing the 2004 calendar test year ("test year").⁶ This decision and order addresses HWSCI's financing request.

²HWSCI's application, filed on February 26, 2004, as amended. See HWSCI's responses, filed on May 18, 2004, to the "Division of Consumer Advocacy's Information Requests."

³Consumer Advocate's position statement, filed on June 29, 2004.

⁴HWSCI's deadline to file a response, if any, to the Consumer Advocate's position statement, expired on July 13, 2004. See Stipulated Procedural Order No. 21071, filed on June 23, 2004, at 2 - 3.

⁵HWSCI's letter, dated July 16, 2004.

⁶See Order No. 20914, filed on April 16, 2004.

II.

Issues

The underlying issue, as set forth in Stipulated Procedural Order No. 21071, is whether HWSCI's financing request, including the encumbering of HWSCI's assets as security for the proposed financing, should be approved. This involves, in turn, a review of the following sub-issues:

1. Whether the proposed financing is for the purposes permitted under HRS § 269-17.
2. Whether the proposed financing will have a material adverse effect on HWSCI's public utility operations.

III.

Financing and Encumbrance

In May 2003, CWSG: (1) closed on its purchase of all the outstanding stock of Kaanapali Water Corporation; and (2) changed the entity's name to HWSCI.⁷

CWSG financed its acquisition of HWSCI with equity and short-term borrowing. HWSCI requests the commission's approval of a capital structure of forty (40) per cent debt and sixty (60) per cent equity. HWSCI states that: (1) it is standard practice in the water utility industry to maintain a capital structure of both long-term debt and equity; and (2) "[f]inancing a portion of utility plant investment with debt generally affords customers a lower overall cost of capital and

⁷Decision and Order No. 20102, filed on March 27, 2003, in Docket No. 02-0372; and HWSCI's counsel's letter, dated May 6, 2003.

provides the utility the flexibility to build necessary improvements without relying solely on new shares or reinvestment."⁸

In order to implement its proposed capital structure, HWSCI requests the commission's approval to issue long-term debt of approximately \$2.8 million. Such long-term debt, HWSCI explains, will be placed at the interest rate then available from Bank of Hawaii, or in the alternative, placed by CWSG at a rate no greater than the rate available from Bank of Hawaii, since CWSG may have the ability to borrow at a lower rate than HWSCI. Any loan terms between CWSG and HWSCI will be passed through without markup.

HWSCI represents that "[t]he \$2.8 million in long-term debt will be used for test year capital improvements and to reimburse [CWSG] for equity contributions used to fund capital improvements made since [HWSCI's] last rate increase request."⁹ Specifically, HWSCI explains that a portion of the \$2.8 million will be used to repay a \$2.244 million note from CWSG.

HWSCI also seeks the commission's approval to issue \$2.2 million in additional long-term debt through 2009, as needed, to fund capital improvements and maintain a reasonable capital structure of both debt and equity.

⁸HWSCI's application, at 7.

⁹Id.

HWSCI, thus, seeks approval to borrow a maximum total of \$5 million in long-term debt, through 2009.¹⁰ The new equity will be raised through paid-in capital from CWSG rather than the issuance of new shares. Thus, HWSCI intends to make contributions of additional paid-in capital as may be necessary to ensure the capital structure remains within the appropriate range.

Based on its *pro forma* statement of cash flow for the period 2004 - 2009, HWSCI projects a capital structure of forty (40) per cent debt and sixty (60) per cent equity.¹¹ HWSCI states that: (1) its projected capital structure is conservative; (2) it should be able to make any and all debt payments; and (3) if a short-term negative cash flow position develops, HWSCI retains the ability to borrow short-term funds from CWSG. In addition, in response to CA-IR-5, HWSCI confirms that the "[e]ncumbrance of the utility's assets would be a term of any loan agreement." See HRS § 269-19.

¹⁰In its response to CA-IR-2, HWSCI clarifies that it is "requesting authority to borrow a total of \$5 million to cover a portion of the capital needs it expects in the period 2004 - 2009. HWSC[I] proposes a single instrument with \$2.8 million drawn between 2005 and 2009 to keep the capital structure within the proposed range of debt/equity ratio through 2009." HWSCI's response to CA-IR-2.

¹¹HWSCI's Exhibit to CA-IR-4(c).

IV.

HRS §§ 269-17 and 269-19

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.

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." HRS § 269-17. "All stock and every stock certificate, and every bond, note, or other evidence of indebtedness of a public utility corporation not payable within twelve months, issued without an order of the commission authorizing the same, then in effect, shall be void." Id.

HRS § 269-19 states that no public utility corporation shall 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." "Every such . . . assignment, mortgage, disposition, encumbrance . . . made other than in accordance with the order of the commission shall be void." HRS § 269-19. The purpose of HRS § 269-19 is to safeguard the public interest. *In re Honolulu Rapid Transit Co.*, 54 Haw. 402, 409, 507 P.2d 755, 759 (1973).

V.

Consumer Advocate

The Consumer Advocate, following its investigation, finds that:

1. The docket record is not clear as to whether the \$2.224 million note from CWSG was in fact used for the purposes set forth in HRS § 269-17.¹² That said, although it is "uncertain as to whether the initial \$2.8 million draw should be used to repay the \$2.244 million note to [CWSG] under the provisions of HRS § 269-17, it appears that monies can be used to finance projects that will be used for the provision of the regulated service. In addition, it appears that the remaining \$2.2 million

¹²See HWSOI's response to CA-IR-1(a).

of the \$5 million loan will also be committed for capital projects to meet the requirements of HRS § 269-17."¹³

2. Although HWSCI has not started its negotiations to secure the financing, it proposes to use substantially similar terms and conditions as those secured by CWSG for its subsidiary, New Mexico Water Service Company ("NMWS").¹⁴ Accordingly, the Consumer Advocate does not object to HWSCI's financing request, "provided that the proposed terms and conditions of HWS[CI's] financing are substantially similar to the terms and conditions of NMWS' financing."¹⁵

The Consumer Advocate states that it does not object to the commission's approval of HWSCI's financing request, provided that:

1. HWSCI file an executed copy of the proposed \$5 million debt agreement, as required by Hawaii Administrative Rules § 6-61-101(b)(2), within fifteen (15) days of the execution of the agreement. If the terms and conditions of HWSCI's \$5 million debt agreement are not substantially similar to NMWS' financing agreement, HWSCI should state the differences and explain the impact of the differences on HWSCI's financial condition

¹³Consumer Advocate's position statement, at 5.

¹⁴See HWSCI's response to CA-IR-4(a).

¹⁵Consumer Advocate's position statement, at 7 (footnote and text therein omitted).

2. HWSCI file an annual status report:
(A) identifying the amount of monies drawn down from the \$5 million loan; and (B) explaining how the use of such monies is consistent with the purposes identified in HRS § 269-17.

3. HWSCI serve copies of its annual financial report filed with the commission, upon the Consumer Advocate, in order to monitor HWSCI's financial condition.¹⁶

The Consumer Advocate concludes by reserving "its right to take issue with the need for the capital improvement projects and the reasonableness of the project costs in the rate proceeding following the in-service date of the projects."¹⁷

VI.

The \$2.244 Million Loan Amount

In its application, HWSCI represented that a portion of "[t]he \$2.8 million in long-term debt will be used . . . to reimburse [CWSG] for equity contributions used to fund capital improvements made since [HWSCI's] last rate increase request."¹⁸ Now, HWSCI explains that the \$2.244 million note payable to CWSG:

. . . was short-term financing put in place to capitalize HWSC at the time of acquisition on April 30, 2003. HWSC intended that this financing

¹⁶The Consumer Advocate represents that it presently is not served with copies of HWSCI's annual financial reports. Telephone conversation with the Consumer Advocate's staff on July 1, 2004, to clarify its proposed condition number 3. See Consumer Advocate's position statement, at 8. See also Decision and Order No. 20102, filed on March 27, 2003, at 6, Ordering Paragraph No. 2, in Docket No. 02-0372, *In re Kaanapali Water Corp., AquaSource Util., Inc., and California Water Serv. Group.*

¹⁷Consumer Advocate's position statement, at 8.

¹⁸HWSCI's application, at 7.

be in place until a formal application to the Commission could be made for long term debt. Because more than one year has elapsed between the outset of this borrowing and Commission approval of long-term financing, this instrument has been renewed for another year.¹⁹

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. . . . the note was incorrectly described as long-term debt. It is short-term debt. HWSC is seeking approval for long-term debt financing in this docket.²⁰

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. the \$2.8 million debt issue will be used first to repay the note from CWS group of \$2.244 million. HWSC intends that this obligation will be fully repaid with the proceeds of the long-term financing.²¹

Thus, HWSCI initially characterized the note as long-term debt, then short-term debt, and now, short-term debt that "has been renewed for another year."²²

The commission finds that the information in the docket record is insufficient to determine whether the \$2.244 million loan will be used for the purposes designated under HRS § 269-17. The note²³ and HWSCI's CA-IR responses are silent as to the intended purposes of the loan from CWSG to HWSCI. As noted by the Consumer Advocate, HWSCI "failed to explain how the \$2.244 million proceeds used to fund the acquisition from [CWSG] equates to monies spent by HWSC to acquire property, plant and

¹⁹HWSCI's response to CA-IR-1(a).

²⁰HWSCI's response to CA-IR-1(c).

²¹HWSCI's response to CA-IR-3(a).

²²HWSCI's response to CA-IR-1(a).

²³HWSCI's response to CA-IR-1(b).

equipment used in the provision of HWSC' regulated water service."²⁴

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

VII.

The \$556,000 and \$2.2 Million Loan Amounts

HWSCI represents that "[t]he \$2.8 million in long-term debt will be used for test year capital improvements and to reimburse [CWSG] for equity contributions used to fund capital improvements made since [HWSCI's] last rate increase request."²⁵ The commission, as stated in Section VI above, however, denies without prejudice the HWSCI's financing request with respect to the loan amount of \$2.244 million.

HWSCI represents that the remaining \$556,000 in long-term debt (\$2.8 million minus \$2.244 million) will be used to fund test year 2004 capital improvements.

HWSCI also represents that the \$2.2 million in additional long-term debt will be used to fund additional capital improvements and to maintain a reasonable capital structure of both debt and equity.

Based on HWSCI's representations, the commission finds that: (1) the \$556,000 and \$2.2 million in loan amounts will be

²⁴Consumer Advocate's position statement, at 5.

²⁵HWSCI's application, at 7.

used for the purposes permitted under HRS § 269-17; and (2) there is no evidence that these loans will have a materially adverse effect on HWSCI's public utility operations. The docket record shows that, at a minimum: (1) HWSCI will expend \$3.782 million during the years 2004 and 2005 for additions to plant; and (2) HWSCI projects "an annual capital budget of \$1.25 million in 2006 through 2009."²⁶

The commission also finds that the encumbrance of HWSCI's utility assets under HRS § 269-19 is consistent with the public interest, as the monies will be used to fund plant additions and other capital improvements for HWSCI's utility operations. The commission, thus, approves HWSCI's financing request for the \$556,000 and \$2.2 million loan amounts.

HWSCI did not file a response indicating whether it objects to or concurs with the Consumer Advocate's proposed conditions. The commission adopts as reasonable the Consumer Advocate's proposed conditions.

VIII.

Capital Structure

In response to HWSCI's proposal to enter into its financing for the purpose of developing a forty (40) per cent debt and sixty (60) per cent equity capital structure, the Consumer Advocate notes that "[t]he proposed debt is necessary to develop a capital structure that reflects some level of debt

²⁶HWSCI's response to CA-IR-5(a).

since the existing capitalization of [HWSCI] presently consists of 100% equity."²⁷ Nonetheless, the Consumer Advocate contends that HWSCI's request to approve its proposed capital structure is more appropriate for the rate increase portion of this proceeding. Thus, "the Consumer Advocate reserves the right to discuss the reasonableness of the proposed 40% debt and 60% equity ratio in the rate increase portion of the instant docket."²⁸

HWSCI did not object to the Consumer Advocate's recommendation to defer the review of the proposed capital structure. The commission will defer the review of HWSCI's proposed capital structure request to the on-going rate case proceeding.²⁹

IX.

Orders

THE COMMISSION ORDERS:

1. HWSCI's financing request with respect to the loan amount of \$2.244 million to repay CWSG is denied, without prejudice.

2. HWSCI's financing request with respect to the loan amounts of \$556,000 and \$2.2 million is approved, consistent with HRS §§ 269-17 and 269-19.

²⁷Consumer Advocate's position statement, at 6.

²⁸Id.

²⁹For the rate case proceeding, the Consumer Advocate issued its initial set of information requests to HWSCI on June 30, 2004, and HWSCI filed its partial responses on July 23, 2004.

3. HWSCI shall file an executed copy of the proposed debt agreement within fifteen (15) days of the execution of the agreement. If the terms and conditions of HWSCI's debt agreement are not substantially similar to NMWS' financing agreement, HWSCI shall state the differences and explain the impact of the differences on HWSCI's financial condition.

4. By January 31st of the following calendar year, HWSCI shall file an annual status report: (A) identifying the amount of monies drawn down from the loan; and (B) explaining how the use of such monies is consistent with the purposes identified in HRS § 269-17. This status report shall be filed annually until the loan amount reaches zero (0).

5. On a prospective basis and unless ordered otherwise, HWSCI shall serve copies of its annual financial reports filed with the commission upon the Consumer Advocate.

6. Two (2) copies of all filings referenced in paragraphs 3 to 5, above, shall be served upon the Consumer Advocate.

7. HWSCI shall conform to all of the commission's orders set forth in paragraphs 3 to 6, above. The failure to adhere to the commission's orders shall constitute cause for the commission to void this decision and order, and may result in further regulatory action as authorized by law.

8. HWSCI's proposed capital structure request is deferred to the on-going rate case proceeding.

DONE at Honolulu, Hawaii this 5th day of August, 2004.

PUBLIC UTILITIES COMMISSION
OF THE STATE OF HAWAII

By Carlito P. Caliboso
Carlito P. Caliboso, Chairman

By Wayne H. Kimura
Wayne H. Kimura, Commissioner

By Janet E. Kawelo
Janet E. Kawelo, Commissioner

APPROVED AS TO FORM:

Michael Azama
Michael Azama
Commission Counsel

03-0275.sl

CERTIFICATE OF SERVICE

I hereby certify that I have this date served a copy of the foregoing Decision and Order No. 21211 upon the following parties, by causing a copy hereof to be mailed, postage prepaid, and properly addressed to each such party.

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DATED: AUG 05 2004