

BEFORE THE PUBLIC UTILITIES COMMISSION  
OF THE STATE OF HAWAII

In the Matter of the Application of )  
 )  
 PUKALANI STP CO., LTD. AND )  
 HAWAII WATER SERVICE COMPANY, INC. )  
 )  
 Requesting Approval of (a) the )  
 Sale of the Assets of Pukalani )  
 STP Co., Ltd. to Hawaii Water )  
 Service Company, Pursuant to Hawaii )  
 Revised Statutes § 269-19; and (b) )  
 Financing Arrangements for New )  
 Utility Improvements, Pursuant to )  
 Hawaii Revised Statutes § 269-17 )  
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DOCKET NO. 2007-0238

DECISION AND ORDER

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DEPT. OF WATER, LAND  
AND  
CONSERVATION  
STATE OF HAWAII

PUBLIC UTILITIES  
COMMISSION

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FILED

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Docket No. 2007-0238

DECISION AND ORDER

By this Decision and Order, the commission approves, subject to certain regulatory conditions described herein, the proposed asset sale and related financing transactions described in the application filed by PUKALANI STP CO., LTD. ("Pukalani") and HAWAII WATER SERVICE COMPANY, INC. ("HWSC") (jointly, "Applicants") on August 21, 2007 ("Application").

I.

Background

A.

Application

On August 21, 2007, Applicants filed their Application, requesting the commission to, among other things: (1) approve pursuant to Hawaii Revised Statutes ("HRS") § 269-19, the sale and transfer of Pukalani's utility assets to HWSC, as described

in an Asset Purchase and Sale Agreement dated June 12, 2007 between Pukalani and HWSC ("Agreement"),<sup>1</sup> including the transfer of Pukalani's authority to provide wastewater collection and treatment service within its territory; (2) order that the currently approved rules, regulations, tariffs, and rates (collectively, "Tariff") of Pukalani shall continue in effect following the closing of the purchase of the utility assets by HWSC, and that HWSC shall republish the Tariff in its own name with the same rules, regulations, and rates; and (3) approve, pursuant to HRS § 269-17, the financing arrangements for new utility improvements, including replacement of the existing wastewater treatment plant, to be made by HWSC following the closing of the purchase of the utility assets by HWSC.

Details about the Applicants and their requests are described below.

1.

Description of Applicants

a.

Pukalani

Pukalani, a Hawaii corporation, is a public utility that provides wastewater collection and treatment services in its service area of Pukalani, Maui.<sup>2</sup> Pukalani Golf Club, LLC, owns

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<sup>1</sup>See Exhibit C to Application.

<sup>2</sup>The commission granted Pukalani its Certificate of Public Convenience and Necessity ("CPCN") in Decision and Order No. 10264, filed on June 30, 1989, in Docket No. 6210. Pukalani's current effective rates were approved by the

all of the common stock of Pukalani. Resort Holdings, LLC, in turn, is the sole member of Pukalani Golf Club, LLC.

Pukalani states that it currently serves approximately 810 residential and commercial customers in the Pukalani Terrace and Country Club Development using a network of sewer and force mains, including two sewage pump stations, to collect the wastewater. The treated effluent is discharged into a two million gallon lake located on Pukalani's property. The effluent, along with water from an irrigation well, is then pumped to the adjacent Pukalani Country Club Golf Course ("Golf Club") for irrigation use. Pukalani's treatment facilities are operated to produce R-2 quality effluent. Pukalani's plant is currently operated and maintained by HWSC pursuant to an operating agreement, which commenced on July 10, 2007.<sup>3</sup>

b.

HWSC

HWSC, a Hawaii corporation, is authorized to provide potable water service in the Kaanapali area on the island of Maui.<sup>4</sup> Specifically, HWSC provides potable water service to resort and residential developments, the latter consisting of the

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commission in Decision and Order No. 22052, filed on September 28, 2005, in Docket No. 05-0025.

<sup>3</sup>Aqua Engineers, Inc. previously operated the wastewater treatment plant under a contract that expired on July 10, 2007. See Application at 5.

<sup>4</sup>See Decision and Order No. 6230, filed on June 9, 1980, in Docket No. 3700.

Kaanapali Golf Estates, Kaanapali Hillside, Kaanapali Vista, Kai Ala, and Royal Kaanapali Estates.<sup>5</sup>

HWSC is a wholly owned subsidiary of California Water Service Group ("CWSG"), a holding company incorporated in Delaware that has provided water utility services through its subsidiaries since 1926.<sup>6</sup> Besides HWSC, Applicants state that CWSG also owns the following operating subsidiaries: (a) the California Water Service Company, which provides water service; (b) the New Mexico Water Service Company, which provides water and wastewater services; (c) Washington Water Service Company, which provides water service; and (d) CWS Utility Services, which is a non-regulated subsidiary.

According to Applicants, CWSG is a public company traded on the New York Stock Exchange; and Standard & Poor's and Moody's have maintained their debt ratings of CWSG's subsidiaries at AA- and Aa3, respectively, "their highest ratings for any of the investor-owned water utilities."<sup>7</sup> Applicants further represent that CWSG and its subsidiaries collectively have available a \$75 million bank line of credit.

2.

Proposed Asset Sale of Pukalani

Pursuant to the Agreement, HWSC will purchase all of Pukalani's assets listed on schedule 1.2 to the Agreement,

<sup>5</sup>See Application at 6.

<sup>6</sup>See id.

<sup>7</sup>Id.

including Pukalani's CPCN, for a purchase price of \$1.00.<sup>8</sup> In connection with the purchase of Pukalani's assets, HWSC will assume the public service obligation to provide wastewater collection and treatment services to Pukalani's existing customers. Applicants therefore also request approval for HWSC to adopt the Tariff and applicable rates previously approved for Pukalani and currently in effect, under which HWSC will provide wastewater utility services to Pukalani's existing customers in the applicable service territory.

In support of their request for approval of the sale, Applicants maintain:

- HWSC is or will be sufficiently fit, willing, and able to provide service to Pukalani's service territory, to satisfy all of its public utility obligations, and to conform to the terms, conditions, rules, and regulations of the commission, and the subject transaction is reasonable and in the public interest.
- Pukalani's wastewater treatment plant is at the end of its useful life and operating at close to its full capacity using obsolete technology. Furthermore, significant development is expected to occur within Pukalani's service area.<sup>9</sup> The sale of Pukalani's assets will enable the requisite improvements to the treatment plant. As the owner of Pukalani's assets, HWSC will diligently pursue the replacement of the existing wastewater treatment plant with a membrane batch reactor treatment plant in order to accommodate

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<sup>8</sup>Applicants assert that the \$1 purchase price was negotiated in recognition that the existing wastewater treatment plant is near the end of its useful life, and that significant funds would be required to construct a new facility to serve existing and future customers. See Applicants' response to CA-IR-6, filed on September 28, 2007.

<sup>9</sup>Pukalani expects the total number of connections, including the existing connections, to increase the demand for wastewater treatment from approximately 200,000 gallons per day ("gpd") to a maximum of approximately 400,000 gpd. See Application at 8.

the planned growth and provide existing customers with reliable service in Pukalani's service area.

- Additionally, the sale of Pukalani's assets to HWSC is in the best interest of the customers served by Pukalani in view of the expertise and financial resources of HWSC and CWSG, its parent company. For example, because of the financial strength of CWSG, CWSG can obtain lower financing costs on a more favorable capitalization structure than its subsidiaries and their individual systems.
- Pukalani has no employees. HWSC currently operates the wastewater operations for Pukalani under an operating agreement, which commenced on July 10, 2007. Upon completion of the acquisition, HWSC will continue to operate the plant, utilizing its own employees.
- HWSC and its upstream affiliates all have extensive experience in the water and wastewater industries to understand the regulatory issues affecting the industry and to provide any necessary support and other services to ensure the successful operation of the acquired utility operations without degradation of service to Pukalani's customers. The above experience clearly demonstrates the ability of HWSC and its parent, CWSG, to successfully own, operate, manage, and maintain the wastewater system currently owned by Pukalani.
- HWSC's willingness to assume the responsibilities of owning Pukalani's utility assets and operating the utility 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.
- HWSC commits and agrees that it shall abide by and conform to all applicable commission rules and orders upon closing of the purchase and sale of the utility assets, if approved by the commission. HWSC will, subject to commission order, continue to be subject to and abide by all rights and

obligations currently imposed on Pukalani in connection with the applicable commission orders, rules, and regulations.<sup>10</sup>

The closing of the asset purchase is conditioned on:

(1) securing the commission's approval of the transaction; and  
(2) the completion of other preconditions specified in the Agreement. The transfer of Pukalani's assets will be completed by the tenth business day after the effective date of the commission's approval, and satisfaction of all other preconditions to closing specified in the Agreement.

3.

Proposed Financing of Cost of Improvements

Following the purchase of Pukalani's assets, HWSC intends to replace the existing wastewater treatment plant with a membrane batch reactor treatment plant in order to accommodate the planned growth in the service area and provide existing customers with reliable service. Applicants estimate the cost of the first two phases of the new plant as \$5,730,080.<sup>11</sup> Pursuant to the Agreement, HWSC will provide 50% of the funding for these improvements, and Pukalani and/or other developers (including Pukalani's affiliate) will provide the other 50% by way of a Contribution in Aid of Construction ("CIAC").

HWSC proposes to obtain the proposed financing through separately placed long term debt or by debt incurred by CWSG.

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<sup>10</sup>See id. at 7-10.

<sup>11</sup>See Exhibit D, attached to Application.

Specifically, Applicants explain that CWSG may issue unsecured debt securities or borrow on its line of credit and will then loan funds to HWSC pursuant to an inter-company promissory note. Under the inter-company promissory note, HWSC will pay the principal, interest, fees, and costs related to the loan proceeds received by HWSC.<sup>12</sup>

Applicants initially represented in the Application that the interest rate and terms of the proposed financing were not presently known because the debt will be issued by negotiated bid. Applicants stated, however, that updates will be provided as they become available.

Subsequently, in response to the Consumer Advocate's information requests, HWSC represented that CSWG expects to obtain financing late in the second quarter of 2008. HWSC will then receive a portion of financing proceeds through an inter-company loan from CSWG at CSWG's pricing, which was 6.25% for the most recent unsecured financing placed in September 2006. In sum, HWSC represented that it presently anticipates the terms of the long-term financing to be as follows:

Amount:	Not to exceed \$3,000,000
Interest rate:	Not to exceed 7.0%
Term:	10 to 30 years
Payment:	Interest only until maturity
Unsecured <sup>13</sup>	

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<sup>12</sup>Applicants attached a sample form of the inter-company promissory note as Exhibit E to the Application.

<sup>13</sup>See HWSC's response to the Consumer Advocate's tenth informal information request, filed on January 31, 2008.

Applicants submitted unaudited financial statements with the Application. Pursuant to Hawaii Administrative Rules ("HAR") § 6-61-92, HWSC requests that its unaudited financial statements be accepted in lieu of the audited financial statements otherwise required by HAR § 6-61-101(b). HWSC states that, as a small public utility, it does not have audited financial reports; and to have them prepared for the Application would delay the filing and would unjustly impose additional financial burdens on HWSC.<sup>14</sup>

B.

Consumer Advocate's Position

On February 20, 2008, the Consumer Advocate filed its Statement of Position ("CA's SOP"), stating that it does not object to the commission approving the Application, subject to certain conditions described further below. The Consumer Advocate explained that, in assessing the reasonableness of Applicants' requests in the Application, the Consumer Advocate focused on the following:

- Are the terms of the Agreement reasonable?
- Is HWSC fit, willing, and able to provide the regulated wastewater service?
- Is the proposed sale of Pukalani's assets, which include the CPCN, to HWSC in the public interest?
- Is it reasonable for HWSC to adopt Pukalani's existing Tariff should the commission approve the sale of Pukalani's assets?

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<sup>14</sup>See Application at 12.

- Is the proposed financing reasonable?<sup>15</sup>

Based on its analysis, the Consumer Advocate made the following assertions and recommendations:

1. The terms and conditions of the Agreement appear reasonable if the conditions below are imposed on Applicants:

- The remaining net book value ("NBV") of the existing plant when title is transferred to HWSC should not be adjusted for the \$1 purchase price. If the facilities are replaced, the NBV of the replaced existing facilities should be zero in future rate proceedings since the facilities would no longer be deemed to be used and useful in the provision of the utility service. In addition, consistent with generally accepted ratemaking principles, there should be no future ratemaking impact on the NBV of the transferred plant that was acquired with CIAC funds since the value of such assets should be offset by the CIAC funds received to acquire the assets.<sup>16</sup>
- Costs have been incurred related to a study performed by Austin and Tsutsumi ("ATA") for the new wastewater treatment facility that is intended to replace the existing plant facilities. If HWSC does not use ATA's recommended design and engineering for the new plant, the cost of the study should not be recovered from ratepayers. This restriction should apply in the event HWSC pursues an alternative plant design, as the costs related to the ATA study would be deemed to be akin to abandoned capital project costs. On the other hand, should HWSC use any of the recommendations set forth in the ATA study, HWSC should be provided an opportunity to recover a portion of the cost of the ATA study that pertains to the recommendations pursued.

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<sup>15</sup>See CA's SOP at 7.

<sup>16</sup>See discussion in Section III.A.1 of CA's SOP.

In a future rate proceeding, HWSC will have the burden of demonstrating the allocation of the ATA study cost that is associated with the recommendations that were pursued.<sup>17</sup>

- Section 1.2(i) of the Agreement excludes from the instant transaction the CIAC payments made to Pukalani for treatment capacity available on the existing wastewater system; and this provision allows Pukalani to retain such CIAC as long as the amounts do not exceed the recorded net cost of the acquired assets listed on Schedule 1.2(a) of the Agreement. Applicants have agreed to amend this section of the Agreement by allowing all of the existing CIAC to be transferred to HWSC at closing. Pukalani, however, will receive a credit in that amount against the \$2.8 million CIAC payment due from Pukalani and/or other developers. Section 1.2(i) of the Agreement should be amended to reflect the current agreement between Applicants.<sup>18</sup>
- Applicants should amend the provision in Section 3.1(b) of the Agreement that allows Pukalani and/or other developers to receive a refund of the \$2.8 million in CIAC payments in the event the actual costs of constructing the replacement plant are less than the estimated \$5.6 million (of which \$2.8 million represents Pukalani and/or other developers' share).<sup>19</sup>
- Pursuant to Section 1.2(c) of the Agreement, the Golf Club will continue to take up to 400,000 gpd of effluent discharged from HWSC's facility for a period of at least ten years, provided the rate charged for the effluent does not exceed the rate currently charged by the County of Maui for irrigation water. Pukalani should be required to demonstrate in future rate cases the reasonableness of the rate to be charged for the effluent. Also, the phrase "currently charged" in this provision is unclear, and Applicants should consider eliminating<sup>20</sup> the word "currently" from the provision.

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<sup>17</sup>See discussion in Section III.A.2 of CA's SOP.

<sup>18</sup>See discussion in Section III.A.3.a of CA's SOP.

<sup>19</sup>See discussion in Section III.A.3.c of CA's SOP.

<sup>20</sup>See discussion in Section III.A.4 of CA's SOP.

- The expense incurred by HWSC to prepare the survey of the wastewater treatment system should be recognized as a transaction cost and not be recovered from ratepayers. In addition, any future costs incurred by HWSC to resolve disputes associated with actions required to access the utility's facilities for repair and maintenance purposes resulting from lawsuits filed by Sports Shinko (Hawaii) Co., Ltd ("Sports Shinko")<sup>21</sup> should be considered as transaction costs and not passed on to ratepayers.<sup>22</sup>
  - The commission should find that any removal or remediation costs should not be recovered from ratepayers, as such costs are deemed to be transaction costs.<sup>23</sup>
  - Applicants should be required to maintain an accounting of the costs incurred to process the Application and record such costs in "below the line" accounts. The accounting will ensure that no costs associated with the processing of the Application are directly or indirectly recovered from ratepayers in future rate proceedings. Furthermore, the separate accounting of costs related to the proposed transaction should at least continue until the next rate case.<sup>24</sup>
2. HWSC appears to be fit, willing, and able to provide the regulated wastewater service.

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<sup>21</sup>Applicants initially represented in their discovery responses that a pending Notice of Pendency of Action on land owned by Pukalani's affiliates should not affect HWSC's ability to secure financing for new construction. See Applicants' response to CA-IR-17c., filed on September 29, 2007. In an updated response to CA-IR-17, Applicants stated that all lawsuits filed by Sports Shinko against affiliates of Pukalani have been settled as of January 18, 2008. See Applicants' updated response to CA-IR-17, filed on January 31, 2008.

<sup>22</sup>See discussion in Section III.A.5 of CA's SOP.

<sup>23</sup>See discussion in Section III.A.6 of CA's SOP.

<sup>24</sup>See discussion in Section III.D of CA's SOP.

The proposed sale of Pukalani's assets, which includes the CPCN, to HWSC is in the public interest.

3. HWSC should be authorized to adopt Pukalani's existing Tariff and simply reflect the change in ownership and service provider. In addition, as a courtesy to Pukalani's customers, notification of the change in ownership and service provider should be provided.
4. The proposed financing meets the restriction set forth in HRS § 269-17 and the terms as presently set forth by HWSC appear to be reasonable. HWSC should be required to submit copies of the actual loan documents once the terms are finalized.

By letter dated and filed on March 13, 2008, Applicants informed the commission that they did not intend to respond to the CA's SOP, and that this matter is ready for decision-making. Applicants further stated:

[I]f the Commission approves the Application, Applicants intend to execute an amendment of the Asset Purchase and Sale Agreement to reflect the following recommendations by the CA: (a) Section 1.2(a) will be amended to allow all of the existing CIAC to be transferred to HWSC at Closing, and to provide that Pukalani will receive a credit in the amount of the transferred CIAC against the \$2.8 million CIAC payment due from Pukalani and/or other developers; and (b) Section 3.1(b) will be amended to provide that CIAC to be paid by Pukalani and/or the other developers will be nonrefundable.<sup>25</sup>

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<sup>25</sup>Letter dated and filed on March 13, 2008, from Applicants to the commission.

II.

Discussion

A.

Proposed Asset Sale of Pukalani

Under State law, the commission is vested with broad powers to review the proposed sale of Pukalani's assets and related proposed financing arrangements by which ownership of Pukalani is ultimately being transferred to HWSC. Specifically, HRS § 269-19, states as follows:

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

HRS § 269-19 (emphasis added).

In addition, HRS § 269-7(a) states, in relevant part:

The public utilities commission . . . shall have power to examine into the condition of each public utility, the manner in which it is operated . . . the issuance by it of stocks and bonds, and the disposition of the proceeds thereof, the amount and disposition of its income, and all its financial transactions, its business relations with other persons, companies, or corporations, its compliance with all applicable state and federal laws and with the provisions of its franchise, charter, and articles of association, if any, its

classifications, rules, regulations, practices, and service, and all matters of every nature affecting the relations and transactions between it and the public or persons or corporations.

HRS § 269-7(a).

Commission approval under HRS § 269-7(a) requires a finding that the proposed sale of assets is "reasonable and consistent with the public interest."<sup>26</sup> A transaction is said to be reasonable and consistent with the public interest if the transaction "will not adversely affect the . . . [utility's] fitness, willingness, and ability to provide" public utility service in the State as authorized in its permit, certificate, or franchise.<sup>27</sup> When reviewing a proposed transfer and related financing requirements under HRS § 269-19, the commission has applied the standard of review of HRS § 269-7.5, which states that the applicant must be "fit, willing, and able properly to perform the service proposed."<sup>28</sup> Thus, when reviewing Applicants'

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<sup>26</sup>See In re Sprint Communications Company, L.P., Sprint Payphone Services, Inc., and ASE Telecom, Inc., Docket No. 05-0045, Decision and Order No. 21715, filed on April 4, 2005 ("Sprint"), at 11 (citing In re ITC^DeltaCom Communications, Inc., et al., Docket No. 02-0345, Decision and Order No. 19874, filed on December 13, 2002); In re Time Warner Telecom of Hawaii, L.P., dba Oceanic Communications, et al., Docket No. 00-0354, Decision and Order No. 18220, filed on November 30, 2000; In re Time Warner Telecom of Hawaii, L.P., dba Oceanic Communications, et al., Docket No. 00-0047, Decision and Order No. 17662, filed on April 10, 2000.

<sup>27</sup>See Sprint at 11-12 (citing In re Ionex Telecommunications, Inc., et al., Docket No. 99-0223, Decision and Order No. 17369, filed on November 8, 1999).

<sup>28</sup>See In re Paradise MergerSub, et al., Docket No. 04-0140, Decision and Order No. 21696, filed on March 16, 2005, at 13 (citing In re Citizens Communications Company, Kauai Electric Division and Kauai Island Utility Co-op, Docket No. 02-0060, Decision and Order No. 19658, filed on September 17, 2002,

requests in the Application under HRS § 269-19, the commission must find that: (1) HWSC will be fit, willing, and able to perform the proposed service under HWSC's ownership; and (2) the transfer is reasonable and in the public interest (collectively and generically referred to as the "Fitness and Public Interest" standard).

1.

HWSC is Fit, Willing, and Able to Perform the Proposed Service

Having reviewed the entire record, the commission finds that the proposed sale of Pukalani's assets, including its CPCN, to HWSC meets the Fitness and Public Interest standard. First, HWSC appears fit, willing, and able to provide the proposed wastewater treatment service. HWSC currently performs the day-to-day operation of Pukalani's wastewater treatment facilities, pursuant to an operating agreement with Pukalani, effective July 10, 2007. Moreover, HWSC appears to have sufficient financial resources to sustain the wastewater treatment operation.<sup>29</sup> As a wholly owned subsidiary of CWSG,

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at 14-15, referencing In re GTE Corp. and Bell Atlantic Corporation, Docket No. 98-0345, Decision and Order No. 17377, filed on November 17, 1999); In re BHP Hawaii Inc., GASCO, Inc. and Citizens Utilities Company, Docket No. 97-0035, Decision and Order No. 15899, filed on September 10, 1997.

<sup>29</sup>As addressed above, pursuant to HAR § 6-61-92, HWSC requests that its unaudited financial statements be accepted in lieu of the audited financial statements otherwise required by HAR § 6-61-101(b). Under HAR § 6-61-92, the commission may modify the requirements of Subchapter 8, HAR Chapter 6-61, in its discretion, if the requirements of the subchapter would impose a financial hardship on the applicant or be unjust or unreasonable. The commission finds good cause to grant HWSC's waiver request in this instance, given HWSC's representation that, as a small

HWSC will also have access to the technical, managerial, and financial support of CWSG. For example, Applicants state that HWSC will have access to lower cost financing due to its affiliation with CWSG, a publicly traded company on the New York Stock Exchange. Based on the above, it appears that HWSC possesses the technical, managerial, and financial ability to operate and manage the acquired wastewater treatment facilities in compliance with existing regulatory requirements.

2.

The Proposed Sale is Reasonable and in the Public Interest

Second, the commission finds that the proposed sale of Pukalani's assets appears reasonable and in the public interest. Applicants represent that Pukalani's wastewater treatment plant is at the end of its useful life and operating at close to its full capacity using obsolete technology.<sup>30</sup> Applicants further state that significant development is expected to occur within Pukalani's service area. Upon review, the commission finds that the sale of Pukalani's assets to HWSC will enable the requisite improvements to Pukalani's treatment plant. Specifically, HWSC's plans to replace the existing wastewater treatment plant should accommodate the planned growth in Pukalani's service area, and provide existing customers with reliable service that is

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public utility, it does not have audited financial reports, and to have them prepared for the Application would delay this proceeding and would unjustly impose additional financial burdens on HWSC.

<sup>30</sup>See Application at 8.

necessary to public health and safety. Because HWSC presently operates the system, there should be a smooth transition in ownership of the system from Pukalani to HWSC. Moreover, Applicants represented in their discovery responses that HWSC's acquisition of Pukalani's assets will result in a lower cost of service than if Pukalani were to retain ownership.<sup>31</sup>

For all of these reasons, the commission concludes that the proposed sale of Pukalani's assets to HWSC is reasonable and in the public interest.

B.

Proposed Financing of Cost of Improvements

Under HRS § 269-17, a public utility must obtain prior commission approval before issuing stocks and stock certificates, bonds, notes, and other evidences of indebtedness payable at periods of more than twelve (12) months after the date of issue. This section restricts the purpose for which stocks and other evidences of indebtedness may be issued to, among other things, the acquisition of property or the construction, completion, extension, or improvement of, or addition to its facilities or services. Moreover, HRS § 269-7(a), cited above, authorizes the commission to examine the condition of every public utility, including all of its financial transactions and its business relations with other persons, companies, and corporations.

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<sup>31</sup>See Applicants' responses to CA-IR-1c. and CA-IR-3b., filed on September 28, 2007.

As noted above, the record indicates that Pukalani's wastewater treatment plant is at the end of its useful life and is operating at close to its full capacity. The proposed financing arrangements are intended to enable HWSC to replace the existing wastewater treatment plant with a membrane batch reactor treatment plant in order to accommodate the planned growth in Pukalani's service territory, and provide existing customers with safe and reliable wastewater treatment service. The Consumer Advocate, based on its review of the Application, concludes that Pukalani's existing plant appears to require replacement, and that the expected terms of the proposed financing appear reasonable.<sup>32</sup> Upon review, the commission finds that the proposed financing requested by Applicants is for permissible purposes under HRS § 269-17 and should be approved.

C.

Consumer Advocate's Recommendations

By letter dated and filed on March 13, 2008, Applicants state that they will amend the Agreement to reflect the following recommendations by the Consumer Advocate:

(a) Section 1.2(a) will be amended to allow all of the existing CIAC to be transferred to HWSC at Closing, and to provide that Pukalani will receive a credit in the amount of the

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<sup>32</sup>The Consumer Advocate notes that the ATA study appears to support Applicants' assertions that the existing plant is obsolete, cannot meet existing demands, and requires replacement. The Consumer Advocate further notes that HWSC presently has no outstanding long term debt, and concludes "it appears that there will be sufficient revenues generated to meet the proposed debt service obligations at the expected terms presented by HWSC." CA's SOP at 30.

transferred CIAC against the \$2.8 million CIAC payment due from Pukalani and/or other developers; and (b) Section 3.1(b) will be amended to provide that CIAC to be paid by Pukalani and/or the other developers will be nonrefundable.<sup>33</sup>

The commission finds these amendments to be reasonable.

Furthermore, although the commission approves herein the proposed sale of Pukalani's assets and related financing requests, based on the Consumer Advocate's recommendations described on pages 31 to 33 of the CA's SOP, the commission adopts the following conditions on the proposed sale and financing arrangements, as reasonable and appropriate in this instance:

(a) The remaining NBV of the existing plant when title is transferred to HWSC shall not be adjusted for the \$1 purchase price. In addition, consistent with generally accepted ratemaking principles, there shall be no future ratemaking impact on the NBV of the transferred plant that was acquired with CIAC funds since the value of such assets should be offset by the CIAC funds received to acquire the assets.

(b) The costs of the ATA study shall not be recovered from ratepayers if HWSC does not implement the recommended design and engineering for the new wastewater treatment facility. If HWSC does use any of the recommendations in the ATA study, HWSC may recover a portion of the cost of the ATA study that pertains to the recommendations pursued. In a future rate case proceeding, HWSC will have the burden of demonstrating the

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<sup>33</sup>Letter dated and filed on March 13, 2008, from Applicants to the commission.

allocation of the ATA study cost that is associated with the recommendations that were pursued.

(c) In connection with Section 1.2(c) of the Agreement, HWSC shall be required to demonstrate in future rate proceedings the reasonableness of the rate to be charged for effluent delivered to the Golf Club.

(d) Any expenses incurred by HWSC to prepare surveys of the wastewater treatment system shall be deemed transaction costs and shall not be recoverable from ratepayers. In addition, although Applicants represent that all lawsuits filed by Sports Shinko against Pukalani's affiliates have been settled, if HWSC incurs any costs in the future related to the Sports Shinko lawsuits, these costs shall be deemed as transaction costs and not passed on to ratepayers.

(e) Any environmental removal or remediation costs shall be deemed as transaction costs and shall not be recovered from ratepayers.

(f) Applicants shall be required to maintain an accounting of the costs incurred to process the Application and record such costs in "below the line" accounts. The separate accounting of costs related to the proposed transaction shall continue until HWSC's next rate case.

(g) HWSC may adopt Pukalani's Tariff and applicable rates previously approved for Pukalani and currently in effect. Upon closing of the proposed sale, HWSC shall refile the Tariff to reflect the change in ownership and service provider.

(h) Promptly after closing of the proposed sale of assets, notice of the change in ownership and service provider of the utility, and any other relevant information, shall be provided to Pukalani's customers, with proof of such notice filed with the commission and the Consumer Advocate.

(i) Related to the proposed financing arrangements, HWSC shall submit copies of the actual loan documents once the financing terms are finalized.

In addition, because upon closing of the asset sale, HWSC will have two CPCNs -- one for Pukalani's service area and one for its Kaanapali service area -- the commission finds it reasonable and appropriate to require HWSC to comply with the following regulatory conditions:

(j) HWSC shall maintain separate books for its Pukalani and Kaanapali operations. It shall file with the commission and also serve upon the Consumer Advocate two separate annual financial reports in accordance with the Uniform System of Accounts - 1996, of the National Association of Regulatory Utility Commissioners, covering its wastewater and water service operations for its Pukalani and Kaanapali operations, respectively. The reports shall be filed no later than March 31 of each year, for the immediate past calendar year. HWSC's annual financial reports shall clearly segregate the Pukalani and Kaanapali operations.

(k) HWSC shall establish and implement accounting procedures and record keeping processes, especially for matters related to allocations of common costs, to ensure that sufficient

records exist to facilitate future regulatory review of any and all regulated, non-regulated, and unaffiliated allocated costs.

(1) The commission's applicable orders, rules, terms and conditions related to Pukalani's wastewater utility operations shall continue in effect, as applied to HWSC, including the commission's requirements for the filing of annual financial reports (see Paragraph (j) above) and payment of public utility fees. HWSC shall separately pay the public utility fees for its Pukalani and Kaanapali operations.

### III.

#### Orders

##### THE COMMISSION ORDERS:

1. The proposed sale of Pukalani's assets to HWSC, including Pukalani's CPCN, and proposed financing arrangements, as described in the Application, are approved, subject to the following regulatory conditions, as discussed in Section II.C of this Decision and Order:

(a) The remaining NBV of the existing plant when title is transferred to HWSC shall not be adjusted for the \$1 purchase price. In addition, consistent with generally accepted ratemaking principles, there shall be no future ratemaking impact on the NBV of the transferred plant that was acquired with CIAC funds since the value of such assets should be offset by the CIAC funds received to acquire the assets.

(b) The costs of the ATA study shall not be recovered from ratepayers if HWSC does not implement the recommended design and engineering for the new wastewater treatment facility. If HWSC does use any of the recommendations in the ATA study, HWSC may recover a portion of the cost of the ATA study that pertains to the recommendations pursued. In a future rate case proceeding, HWSC will have the burden of demonstrating the allocation of the ATA study cost that is associated with the recommendations that were pursued.

(c) In connection with Section 1.2(c) of the Agreement, HWSC shall be required to demonstrate in future rate proceedings the reasonableness of the rate to be charged for effluent delivered to the Golf Club.

(d) Any expenses incurred by HWSC to prepare surveys of the wastewater treatment system shall be deemed transaction costs and shall not be recoverable from ratepayers. In addition, although Applicants represent that all lawsuits filed by Sports Shinko against Pukalani's affiliates have been settled, if HWSC incurs any costs in the future related to the Sports Shinko lawsuits, these costs shall be deemed as transaction costs and not passed on to ratepayers.

(e) Any environmental removal or remediation costs shall be deemed as transaction costs and shall not be recovered from ratepayers.

(f) Applicants shall be required to maintain an accounting of the costs incurred to process the Application and record such costs in "below the line" accounts. The separate

accounting of costs related to the proposed transaction shall continue until HWSC's next rate case.

(g) HWSC may adopt Pukalani's Tariff and applicable rates previously approved for Pukalani and currently in effect. Upon closing of the proposed sale, HWSC shall refile the Tariff to reflect the change in ownership and service provider.

(h) Promptly after closing of the proposed sale of assets, notice of the change in ownership and service provider of the utility, and any other relevant information, shall be provided to Pukalani's customers, with proof of such notice filed with the commission and the Consumer Advocate.

(i) Related to the proposed financing arrangements, HWSC shall submit copies of the actual loan documents once the financing terms are finalized.

(j) HWSC shall maintain separate books for its Pukalani and Kaanapali operations. It shall file with the commission and also serve upon the Consumer Advocate two separate annual financial reports in accordance with the Uniform System of Accounts - 1996, of the National Association of Regulatory Utility Commissioners, covering its wastewater and water service operations for its Pukalani and Kaanapali operations, respectively. The reports shall be filed no later than March 31 of each year, for the immediate past calendar year. HWSC's annual financial reports shall clearly segregate the Pukalani and Kaanapali operations.

(k) HWSC shall establish and implement accounting procedures and record keeping processes, especially for matters related to allocations of common costs, to ensure that sufficient records exist to facilitate future regulatory review of any and all regulated, non-regulated, and unaffiliated allocated costs.

(l) The commission's applicable orders, rules, terms and conditions related to Pukalani's wastewater utility operations shall continue in effect, as applied to HWSC, including the commission's requirements for the filing of annual financial reports (see Paragraph (j) above) and payment of public utility fees. HWSC shall separately pay the public utility fees for its Pukalani and Kaanapali operations.

(m) As provided in Applicants' March 13, 2008 letter to the commission, Applicants shall (i) amend Section 1.2(a) of the Agreement to allow all of the existing CIAC to be transferred to HWSC at closing, and to provide that Pukalani will receive a credit in the amount of the transferred CIAC against the \$2.8 million CIAC payment due from Pukalani and/or other developers; and (ii) amend Section 3.1(b) of the Agreement to provide that the CIAC to be paid by Pukalani and/or the other developers will be nonrefundable.

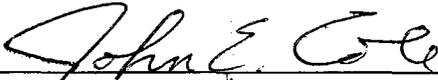
2. HWSC's waiver request under HAR § 6-61-92 to submit unaudited financial statements in lieu of the requirements under HAR § 6-61-101(b), is granted.

3. Applicants shall timely comply with all of the regulatory conditions and other requirements set forth herein, as applicable. Failure to comply with any of these regulatory conditions and requirements may constitute cause to void this Decision and Order, and may result in further regulatory action, as authorized by State law and commission rules and regulations.

DONE at Honolulu, Hawaii JUN 12 2008.

PUBLIC UTILITIES COMMISSION  
OF THE STATE OF HAWAII

By   
Carlito P. Caliboso, Chairman

By   
John E. Cole, Commissioner

By   
Leslie H. Kondo, Commissioner

APPROVED AS TO FORM:

  
Kaiulani Kidani Shinsato  
Commission Counsel

2007-0238.cp

CERTIFICATE OF SERVICE

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

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