

DEPARTMENT OF PUBLIC SERVICE REGULATION
BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MONTANA

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| IN THE MATTER of the Consolidated |) | REGULATORY DIVISION |
| Petition by Mountain Water Company for |) | |
| Declaratory Rulings and Application for |) | DOCKET NO. D2011.1.8 |
| Approval of Sale and Transfer of Stock in |) | |
| Park Water Company |) | |

Testimony
of
John W. Wilson
on Behalf
of
The Montana Consumer Counsel

PUBLIC VERSION

[PROTECTED MATERIAL REDACTED]

July 29, 2011

J.W. Wilson & Associates, Inc.

Economic Counsel

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I. QUALIFICATIONS

Q. PLEASE STATE YOUR NAME, OCCUPATION, AND ADDRESS.

A. My name is John W. Wilson. I am President of J.W. Wilson & Associates, Inc. Our offices are at 1601 North Kent Street, Suite 1104, Arlington, Virginia, 22209.

Q. PLEASE OUTLINE YOUR EDUCATIONAL BACKGROUND.

A. I hold a B.S. degree with senior honors and a Masters Degree in Economics from the University of Wisconsin. I have also received a Ph.D. in Economics from Cornell University. My major fields of study were industrial organization and public regulation of business, and my doctoral dissertation was a study of utility pricing and regulation.

Q. HOW HAVE YOU BEEN EMPLOYED SINCE THAT TIME?

A. After completing my graduate education I was an assistant professor of economics at the United States Military Academy, West Point, New York. In that capacity, I taught courses in both economics and government. While at West Point, I also served as an economic consultant to the Antitrust Division of the United States Department of Justice.

1 After leaving West Point, I was employed by the Federal Power
2 Commission, first as a staff economist and then as Chief of FPC's
3 Division of Economic Studies. In that capacity, I was involved in
4 regulatory matters involving most phases of FPC regulation of electric
5 utilities and the natural gas industry. Since 1973 I have been employed
6 as an economic consultant by various clients, including federal, state,
7 provincial and local governments, private enterprise and nonprofit
8 organizations. This work has pertained to a wide range of issues
9 concerning public utility regulation, insurance rate regulation, antitrust
10 matters and economic and financial analysis. In 1975 I formed J.W.
11 Wilson & Associates, Inc., a Washington, D.C. corporation.

12 **Q. WOULD YOU PLEASE DESCRIBE SOME OF YOUR**
13 **ADDITIONAL PROFESSIONAL ACTIVITIES?**

14 A. I have authored a variety of articles and monographs, including a
15 number of studies dealing with utility regulation and economic policy. I
16 have consulted on regulatory, financial and competitive market matters
17 with the Federal Communications Commission, the National Academy
18 of Sciences, the Ford Foundation, the National Regulatory Research
19 Institute, the Electric Power Research Institute, the U.S. Department of
20 Justice Antitrust Division, the Federal Trade Commission Bureau of
21 Competition, the Commerce Department, the Department of the Interior,

1 the Department of Energy, the Small Business Administration, the
2 Department of Defense, the Tennessee Valley Authority, the Federal
3 Energy Administration, and numerous state and provincial agencies and
4 legislative bodies in the United States and Canada.

5 Previously, I was a member of the Economics Committee of the U.S.
6 Water Resources Council, the FPC Coordinating Representative for the
7 Task Force on Future Financial Requirements for the National Power
8 Survey, the Advisory Committee to the National Association of
9 Insurance Commissioners (NAIC) Task Force on Profitability and
10 Investment Income, and the NAIC's Advisory Committee on Nuclear
11 Risks.

12 In addition, I have testified as an expert witness in court proceedings
13 dealing with competition in the electric power industry and on
14 regulatory matters before more than 50 Federal and State regulatory
15 bodies throughout the United States and Canada. I have also appeared
16 on numerous occasions as an expert witness at the invitation of U.S.
17 Senate and Congressional Committees dealing with antitrust and
18 regulatory legislation. In addition, I have been retained as an expert on
19 regulatory matters by more than 25 State and Federal regulatory
20 agencies. I have also participated as a speaker, panelist, or moderator in
21 many professional conferences and programs dealing with business

1 regulation, financial issues, economic policy and antitrust matters. I am
2 a member of the American Economic Association and an associate
3 member of the American Bar Association and the ABA's Antitrust,
4 Insurance and Regulatory Law Sections.

5 **II. OVERVIEW OF TESTIMONY**

6 **Q. ON WHOSE BEHALF ARE YOU TESTIFYING IN THIS**
7 **PROCEEDING?**

8 A. I am presenting testimony in this proceeding on behalf of the Montana
9 Consumer Counsel (MCC).

10 **Q. PLEASE SUMMARIZE YOUR TESTIMONY?**

11 A. My testimony in this case concerns the proposed acquisition of Park
12 Water Company, the parent of Mountain Water, by Western Water
13 Holdings, LLC, a subsidiary of Carlyle Infrastructure Partners, which is
14 part of The Carlyle Group, a large privately owned investment firm
15 ("Carlyle"). The issues that I address include Carlyle's apparent post-
16 acquisition business plan for Park and Mountain Water, the expected
17 duration of Carlyle's ownership, acquisition rights to Mountain Water
18 upon Carlyle's ownership exit and conditions for acquisition approval
19 ("ring-fencing").

1 **Q. IS CARLYLE AN EXPERIENCED OWNER/OPERATOR OF**
2 **WATER UTILITIES?**

3 A. No. While stating in its Petition and Application that Carlyle
4 Infrastructure Partners “invests primarily in transportation and water
5 infrastructure assets in the U.S. and Canada,” this proposed acquisition
6 would be Carlyle’s initial investment in the public utility water sector.
7 Carlyle Infrastructure’s other business investments are a recycler of
8 waste and wastewater residuals in Texas, a joint venture with Subway
9 Restaurants operating highway service plazas in Connecticut, a lift-
10 on/lift-off container operation for trucks and trains and a school bus
11 transportation business in central Illinois.

12 With the exception of Park Water’s principal owner and co-CEO, who
13 will retire when Carlyle takes over, Carlyle states that it will retain Park
14 Water’s (and Mountain Water’s) existing management and continue to
15 operate the water utility without any significant changes.

16 **Q. SHOULD THE COMMISSION BE CONCERNED ABOUT**
17 **CARLYLE’S APPARENT LACK OF EXPERIENCE IN THE**
18 **WATER UTILITY INDUSTRY?**

19 A. Given Carlyle’s stated intention to retain Park and Mountain’s existing
20 management, that should not be a major concern.

1 **Q. ARE THERE OTHER MATTERS THAT MAY BE OF**
2 **CONCERN TO THE COMMISSION REGARDING THE**
3 **PROPOSED ACQUISITION?**

4 **A.** Yes. First, it seems clear that Carlyle’s business plan for Mountain
5 Water may very likely include substantially more rate base investment
6 (and corresponding future rate increases) than had previously been
7 planned by Park’s management. While this is not necessarily
8 undesirable, assuming that the enhanced investments provide more
9 benefits than costs, it does represent a major change in business strategy
10 that the Commission should be aware of and monitor to avoid the
11 potential for rate base inflation that is overly costly to consumers.

12 Second, and related to the first point, though Carlyle has said repeatedly
13 that it intends to be a long-term owner of Mountain Water (see
14 responses to PSC-011 b, CFC-008 d, and Dove testimony at 4),
15 discovery in this case appears to reveal a plan for Carlyle to “exit” its
16 investment in Park and Mountain Water within (redacted text) years of
17 acquisition, after building up the Company’s rate base and enterprise
18 market value. Also relatedly, while Carlyle appears to reaffirm a right
19 of first refusal (“ROFR”) to the City of Missoula should it seek to sell
20 Mountain Water (see responses to PSC-011 b and CFC-008 d), that
21 representation too may be questionable based on discovery responses.

1 Finally, given the Company's proposed change in ownership, its new
2 business plan and its new affiliation with the Carlyle Group, together
3 with the Commission's historic interest in ring-fencing jurisdictional
4 utility finances, this would be an opportune time for the Commission to
5 require ring-fencing of the Mountain Water utility in a manner similar to
6 other utility ring-fencing that has been implemented in Montana. The
7 timeliness for implementing ring-fencing in this proceeding is
8 underscored by Carlyle's recent acceptance of similar acquisition
9 conditions in California.

10 **III. CARLYLE'S BUSINESS PLAN**

11 **Q. WHAT IS THE BASIS FOR EXPECTING THAT CARLYLE'S**
12 **BUSINESS PLAN INCLUDES SUBSTANTIALLY MORE RATE**
13 **BASE INVESTMENT THAN WAS PREVIOUSLY PLANNED BY**
14 **PARK'S MANAGEMENT?**

15 **A.** Because Carlyle declined to respond fully to data request MCC-004, the
16 basis for this expectation is not as clear as it should be. The
17 Commission may therefore wish to compel a full answer to that data
18 request so that there is no doubt as to this or other aspects of Carlyle's
19 post acquisition plans that may be unclear. Data Request MCC-004
20 asked:

1 Please provide the financial analysis that was done in conjunction
2 with Carlyle's due diligence pertaining to the acquisition of Park
3 Water including but not limited to projected financial results (e.g.,
4 income statements, balance sheets, cash flow). If these due diligence
5 analyses are in spread sheet form, please provide them in an
6 operating format with all formulas and links intact.

7
8 In response, Carlyle admitted to performing such analyses, including
9 expected earnings from ratebasing new infrastructure investments in the
10 water utility and from a potential future sale of Park Water, but objected to
11 providing these analyses on the basis of "relevance." Instead, Carlyle
12 provided what it described as its "financial analysis in summary format to
13 explain why, from Carlyle's perspective it is pursuing this investment..."

14 This "summary" is a narrative memorandum written in October of 2010,
15 without any of the spread sheets or details that had been performed and
16 requested. The summary does, however, appear to indicate that Carlyle
17 plans to "exit" its investment in Park Water in (redacted text), realizing a
18 compound annual internal rate of return (profit) of (redacted text)% per
19 year.

20 This is a very large annual return. One may speculate that it is the result of
21 capital gains assumptions stemming from assumed increases in P/E¹ and

¹ P/E = price/earnings ratio. This is a measure of stock price in relation to earnings. It is a "valuation multiple" reflecting how much investors are currently willing to pay for each dollar of expected annual earnings. In this case it appears that Carlyle believes that it is acquiring Park Water and its affiliates at a (redacted text)P/E than the P/E at which it expects to be able to resell the Company at its projected exit date.

1 EBITDA² multiples by the exit date, coupled with robust capital investment
2 and rate base growth over the next (redacted text) years. Assuming that the
3 capital investment and rate base growth are economic (i.e., benefits exceed
4 costs), this may not be objectionable. However, without the requested
5 model and spread sheets that Carlyle apparently has prepared but refuses to
6 provide, one cannot be sure. If, instead, as in the prior case of Babcock and
7 Brown's proposed acquisition of Northwestern, the projected return is the
8 result of assumed equity payouts or other factors that would be revealed in
9 the model, the consequences for the Company's customers and for Montana
10 could be problematic.

11 **Q. WAS THERE PRECEDENT FOR REQUESTING THE DETAILED**
12 **ANALYSIS THAT WAS SOUGHT IN MCC-004?**

13 A. Yes. This is the same information that was requested and obtained from
14 Babcock and Brown, which modeled that Company's post acquisition
15 financial plans and expectations for NorthWestern Energy. In that case, the
16 company's financial model revealed Babcock and Brown's intention to pay
17 out the utility's equity capital, so as to recapture its acquisition premium,

² EBITDA = Earnings Before Interest, Taxes, Depreciation and Amortization. It is essentially a measure of "interest coverage" in that it reflects the amount a company has available to pay interest and to repay principle. EBITDA first became a popular valuation metric with respect to leveraged buyouts in the 1980s as a reflection of the buyer's ability to service debt. Today it is frequently used as an earnings metric with respect to capital intensive assets that are written down over long periods. Carlyle's assessment of the proposed Park Water acquisition evaluated the price to be paid for Park Water in terms of an EBITDA multiple. Apparently, Carlyle believes that it is acquiring Park Water and its affiliates at a (redacted text) EBITDA multiple than the multiple Carlyle expects to realize upon resale at the exit date.

1 after the Commission approved its proposed acquisition of NorthWestern.
2 This signaled the likelihood of severe financial difficulties and was an
3 important basis for the Commission's rejection of the proposed takeover.
4 The requested modeling results that were evidently prepared in this case by
5 Carlyle but not produced would provide a clearer and more detailed picture
6 than we now have of Carlyle's post acquisition plans and expectations with
7 respect to Park and Mountain Water.

8 **Q. DO YOU EXPECT THAT CARLYLE'S FINANCIAL PLANS WITH**
9 **RESPECT TO MOUNTAIN WATER ARE SIMILAR TO BABCOCK**
10 **AND BROWN'S PLANS FOR NORTHWESTERN?**

11 A. No. While one cannot be certain without the requested discovery, it
12 appears from the summary that was provided in response to MCC-004 that
13 Carlyle's plans are nearly the opposite. That is, rather than paying out the
14 utility's equity capital to itself after the acquisition, it appears that Carlyle's
15 intent is to invest further in water utility infrastructure, including the
16 reinvestment of earnings as opposed to dividend payouts. Carlyle's
17 business strategy appears to be one of growing equity investment at a more
18 rapid rate than Park has done in the past or has planned for the future, and
19 then exiting in (redacted text) years with a substantial capital gain resulting
20 from that investment and its incorporation into the utility's rate base. The
21 planned exit would apparently be accomplished either by selling the utility

1 operations or through an initial public offering (“IPO”) of the water
2 company’s stock. While this is not at all the threat to utility financial
3 solvency that was posed by Babcock and Brown’s planned takeover of
4 NorthWestern, if accurate, it does pose a different potential problem for the
5 Commission and the Company’s ratepayers.

6 **Q. WHAT IS THE POTENTIAL REGULATORY AND RATEPAYER**
7 **PROBLEM WITH THIS PLAN?**

8 A. Additional investment in utility infrastructure is beneficial to consumers
9 and to the Montana economy when the benefits derived from the additional
10 investment exceed its cost. Infrastructure investment becomes utility rate
11 base that consumers must pay for. Consumers must pay both a rate of
12 return on these investments as well as repaying the investments themselves
13 over time through annual depreciation charges. If a 40-year old water main
14 that is fully depreciated and a new main costing thousands of dollars
15 provide equivalent service, the nearly free old main will provide much
16 more net benefit for consumers than the new one requiring substantially
17 higher water rates.

18 **Q. IS IT LIKELY THAT THESE CIRCUMSTANCES EXIST ON THE**
19 **MOUNTAIN WATER SYSTEM?**

20 A. Yes. This was a significant issue in Mountain Water’s last rate case before

1 the Commission, in which there was considerable discussion and evidence
2 concerning water loss from some of the Company's older mains and the
3 cost of replacing those old mains. As stated in the testimony of Mountain
4 Water witness John A. Kappes:

5 The cost of water loss from company-owned mains in 2009 was
6 estimated to be \$366,000. While this figure may seem large, it
7 represents only about 2.2% of the annual operating revenues for the
8 year. In contrast, to replace all main 40 years old or older would
9 result in ratepayer increase of over 100%. (Kappes prepared direct
10 testimony at 12)

11

12 Mr. Kappes went on to show in his Exhibit JK-1 that the cost of replacing
13 Mountain Water's 674,282 feet of main that was 40 years old or older
14 would cost \$128.6 million. Obviously, this would be an excessive
15 investment to achieve cost savings of \$366,000 per year. Mr. Kappes also
16 estimated that it would cost an additional \$44.3 million to replace
17 Mountain Water's 8,862 customer-owned service lines that were 40 years
18 old or older, resulting in savings of \$196,000 annually – again an
19 excessively costly investment.

20 **Q. WHAT IS YOUR RECOMMENDATION TO THE COMMISSION**
21 **REGARDING THIS ISSUE?**

22 A. First, the Commission may wish to require that Carlyle provide the detailed
23 analyses that were performed by the Company but not provided in response

1 to MCC-004. Second, if it is confirmed that Carlyle’s business strategy is
2 as suggested above, the Commission should emphasize that rate base
3 investments costing more than the benefits they provide are harmful to
4 consumers and will not be authorized a compensatory return or cost
5 recovery. Given Carlyle’s apparent business strategy, care should be taken
6 in each of the Company’s (or its successor’s) subsequent rate cases in
7 which new investments are proposed to be added to rate base to assure that
8 the costs involved are, in fact, justified by their associated benefits (cost
9 savings). If that is done, the potential excessive investments, as described
10 previously by Mr. Kappes, may not become an unwarranted ratepayer
11 burden.

12

13

IV. RIGHT OF FIRST REFUSAL

14 **Q. YOU STATED EARLIER THAT WHILE CARLYLE APPEARS TO**
15 **REAFFIRM A RIGHT OF FIRST REFUSAL (“ROFR”) TO THE**
16 **CITY OF MISSOULA SHOULD IT SEEK TO SELL MOUNTAIN**
17 **WATER, THAT INFERRED RIGHT MAY BE A QUESTIONABLE**
18 **MATTER IN LIGHT OF DISCOVERY RESPONSES. COULD YOU**
19 **ELABORATE?**

20 **A. Yes. There appear to be ROFR reaffirmations in data responses PSC-011 b**

1 and CFC-008 d. However, this issue is also discussed in more detail at
2 page 6 of the October 7, 2010 memorandum provided in response to MCC-
3 004. Carlyle's discussion there (as written by Mr. Dove and Mr. Gold)
4 casts doubt on circumstances in which Missoula's ROFR may be
5 applicable:

6 (redacted text)

7
8 If this viewpoint prevails in the future, (redacted text) While the MCC takes
9 no position on this matter, if the Commission intends for Missoula to have
10 an ROFR to acquire Mountain Water when, as projected, Carlyle exits its
11 Park Water investment in the not too distant future, that entitlement should
12 be made clear in conjunction with the approval of this transaction.

13 **Q. OTHER THAN YOUR INTERPRETATION OF WHAT IS**
14 **INDICATED IN CARLYLE'S RESPONSE TO MCC-004, IS THERE**
15 **AN ADDITIONAL BASIS FOR EXPECTING THAT CARLYLE**
16 **EXPECTS TO EXIT THE PARK WATER INVESTMENT IN THE**
17 **FORESEEABLE FUTURE?**

18 **A.** Yes. As stated in response to PSC-014 e:

19 Carlyle Infrastructure is a limited life entity and is scheduled to
20 expire on September 28, 2019, although under the provisions of
21 Section 2.7 of the LPA that date may be extended for another two
22 years. Section 9 of the LPA provides that investments remaining in

1 the fund upon termination are to be disposed of in an orderly manner
2 through a dissolution sale (or distribution to limited partners),
3 although no time frame for this sale of distribution is noted.

4
5 Thus, even if the (redacted text) time frame for Carlyle's exit from this
6 water utility investment, as indicated in the summary memorandum
7 provided in response to MCC-004, were not operative, the fact that Carlyle
8 Infrastructure is, itself, a limited life entity, strongly affirms that Carlyle's
9 proposed investment in Park and Mountain Water is intended to be retained
10 for only a limited period of time.

11 **V. RING-FENCING CONDITIONS**

12 **Q. WHY ARE RING-FENCING MEASURES NECESSARY?**

13 A. Both the proposed sale to Carlyle and the planned new business emphasis
14 on growth, including growth through acquisition (especially in California)
15 introduce new regulatory and consumer protection issues. These enhanced
16 regulatory and consumer protection concerns, which are related to
17 expansive corporate policies and possible inter-corporate transactions and
18 financing issues, could, without adequate safeguards, impose unwarranted
19 costs on the Montana economy and on Montana utility ratepayers. While
20 Carlyle has not yet revealed (or, very likely, even decided upon) all of the
21 specific objectives of its new water utility venture, there are certain known
22 specifics which indicate the potential importance of ring-fencing Mountain

1 Water's utility finances and operations at this time for the benefit of
2 Montana utility ratepayers. Among these is the fact that Carlyle has
3 already targeted (redacted text) as possible add-on or "tuck-in" acquisitions
4 by Park. See Appendix IV, page 21 of the response to MCC-004.

5 **Q. IS IT REASONABLE TO EXPECT THAT RING-FENCING CAN**
6 **ADEQUATELY PROTECT MONTANA RATEPAYERS GIVEN**
7 **CARLYLE'S GROWTH AND ACQUISITION GOALS?**

8 A. Yes; but only if the ring-fencing that is implemented is thorough and
9 comprehensive and if enforcement is effective. In this regard, the most
10 important ring-fencing provisions are limitations on dividends to
11 adequately protect the Montana utility's equity capital base and limitations
12 on any transfer of Mountain Water assets or their use in conjunction with
13 parent or affiliate financing.

14 **Q. HAVE THE MAJOR CREDIT RATING AGENCIES STRESSED**
15 **THESE SAME RING-FENCING PROVISIONS?**

16 A. Yes. Standard and Poors (S&P), Moody's and Fitch have all affirmed that
17 strong ring-fencing, together with effective regulatory enforcement, will
18 serve to strengthen the financial ratings of utility companies, especially
19 utility operating subsidiaries.

1 See: Standard & Poors, "Ring-Fencing a Subsidiary" by James
2 Penrose, Esq., Arthur F. Simonson, Ronald M. Barone and Richard
3 W. Cortwright, Jr., 2007 www.standardpoors.com. Also see
4 Moody's Investors Service Announcement: Terasen, Inc., 14
5 October, 2005 and Fitch Ratings, Sharon Borelli, Senior Director,
6 September 17, 2003.

7
8 All of the major rating agencies stress limitations on dividend payments to
9 parent companies as a key means of maintaining strong utility capitalization
10 and credit ratings. They also support strict limitations on affiliate loans,
11 money pools and other financial support, as well as mandated capital
12 structure limits. In order to be effective, all of these ring-fencing provisions
13 must be implemented prior to the occurrence of financial distress.

14 **Q. WHAT RING-FENCING CONDITIONS SHOULD THE**
15 **COMMISSION IMPLEMENT FOR MOUNTAIN WATER?**

16 **A.** The Commission should implement ring-fencing conditions for Mountain
17 Water that are similar to those it has established for other Montana utilities
18 in recent years, such as the following:

- 19 a. The Commission or its agents may audit the accounts of Mountain
20 Water Company ("MWC"), its parent and its subsidiaries and affiliates
21 which are the bases for charges to, or transfers from MWC or its parent.
22 MWC and its parent shall cooperate fully with such Commission audits.

- 1 b. MWC and its parent shall provide the Commission access to all books
2 of account, as well as all documents, data and records of their affiliated
3 interests, which pertain to transactions between MWC or its parent and
4 its affiliated interests.
- 5 c. MWC shall maintain its own financial and business operating accounts,
6 separate from its parent's and its affiliates' accounts. All financial and
7 operating books and records of MWC and those of its parent and
8 subsidiaries shall be completely and immediately accessible at
9 Missoula, Montana.
- 10 d. There is no provision that MWC shall maintain its own debt, in
11 recognition of the historic practice of MWC's parent issuing debt on a
12 consolidated basis. If these financing circumstances change in the
13 future or if debt is to be incurred for acquisition purposes, appropriate
14 debt ring-fencing conditions may be required. If, at any time, MWC's
15 parent or affiliates intend to issue debt for the purpose of acquiring other
16 utility or nonutility companies, those financing intentions must be filed
17 with the Commission at least 120 days in advance of any such financing
18 so that the Commission may implement appropriate debt ring-fencing
19 provisions.

- 1 e. MWC shall not make any distribution to its parent or to any affiliates
2 that would cause MWC's equity capital to fall below 45 percent of
3 MWC's net utility plant balance (utility plant in service less
4 accumulated depreciation and amortization). without first obtaining
5 Commission approval. Also, MWC's parent, Park Water, shall
6 maintain a capital structure equity percentage of at least 45 percent, on a
7 Park-and-subidiaries-consolidated basis, except to the extent that the
8 Commission imputes a lower equity percentage for ratemaking
9 purposes. The Commission may re-examine these minimum common
10 equity percentages as financial conditions change, and may determine
11 that they be adjusted.
- 12 f. MWC and its parent shall provide the Commission unrestricted access
13 to all written information provided to common stock, bond, or bond
14 rating analysts, which directly or indirectly pertains to MWC, its parent
15 or any affiliate that exercises influence or control over MWC. Such
16 information includes, but is not limited to, reports provided to, and
17 presentations made to, common stock analysts and bond rating analysts.
18 For purposes of this condition, "written" information includes but is not
19 limited to any written and printed material, audio and video tapes,
20 computer disks and electronically-stored information. Nothing in this

1 condition shall be deemed to be a waiver of MWC's right to seek
2 protection of the information.

3 g. Unless such a disclosure is determined to be unlawful in an opinion of
4 counsel provided to the Commission, MWC shall notify the
5 Commission of:

6 1. Its intention to transfer more than 5 percent of MWC's retained
7 earnings to its parent or affiliates (or any combination thereof) over a
8 six-month period, at least 60 days before such a transfer begins.

9 2. Its intention to declare a special cash dividend from MWC, at least
10 30 days before declaring each such dividend.

11 3. Its most recent regular common stock cash dividend from MWC
12 within 10 days after declaring each such dividend.

13 h. MWC's parent, subsidiaries and affiliates shall not allocate to or directly
14 charge MWC expenses not specifically authorized by the Commission
15 to be so allocated or directly charged.

16 i. Without the prior and specific authorization of the Commission, neither
17 MWC nor its parent shall transfer, merge, sell, lease, encumber or
18 otherwise dispose of MWC's utility property which (a) has a net book

1 value in excess of \$1,000,000 which is included in Montana rate base,
2 and (b) has costs recovered through rates regulated by the Commission.

3 j. The following principles shall apply to any new financing involving
4 utility property of MWC which (a) is included in Montana rate base, or
5 (b) has costs recovered through rates regulated by the Commission:

6 a. proceeds of debt that is secured by utility assets must be used for
7 utility purposes only;

8 b. if any utility assets that are pledged or encumbered to secure debt
9 issuances are divested, the debt must „follow’ the assets and be
10 divested as well;

11 c. if utility assets financed by unsecured debt are divested to
12 another entity, then a proportionate share of the debt also must be
13 divested;

14 d. if assets financed with unsecured debt are divested, the
15 associated unsecured debt must follow those assets. Specifically,
16 if any of the proceeds from unsecured debt are used for non-
17 utility purposes, the debt likewise must “follow” the non-utility
18 assets and if the non-utility assets are divested or “spun off” then
19 a proportionate share of the debt must follow the associated non-
20 utility assets by being divested or “spun off” as well. The term

1 “divested” in this context includes moving assets to both
2 affiliated and non-affiliated corporations.

3 k. In the event that MWC or its parent participates in a “cash management
4 pool” or “treasury pool” arrangement, or otherwise engages in intra-
5 corporate financing with affiliates, MWC shall file for Commission
6 approval a cash management plan incorporating best practices for
7 protecting MWC’s and it parent’s credit from the risks associated with
8 participating in a shared money pool with such affiliates.

9 In addition to these specific Montana ring-fencing provisions, the
10 Commission may also wish to adopt the “Conditions of Approval of the
11 Proposed Transaction” that Carlyle has agreed to adopt in California, which
12 include certain other ratepayer protections. For the Commission’s
13 convenience these California conditions are included as Exhibit ____ (JW-
14 1).

15 **Q. DOES THIS CONCLUDE YOUR PREPARED DIRECT**
16 **TESTIMONY AT THIS TIME?**

17 **A.** Yes; it does.

APPENDIX A

Conditions of Approval of the Proposed Transaction

1. The proposed transaction shall have no effect on the Commission's authority over the provision of public utility service to the public by Park Water Company ("Park Water") and Apple Valley Ranchos Water Company ("AVR").

2. Park Water and AVR shall comply with all applicable California and federal laws and administrative regulations.

3. Western Water Holdings, LLC ("Western Water") shall ensure that Park Water and AVR have adequate capital to fulfill all of their public utility service obligations. The term "capital" encompasses "money and property with which a company carries on its corporate business; a company's assets, regardless of source, utilized for the conduct of the corporate business and for the purpose of deriving gains and profits; and a company's working capital," and is not limited to mean only "equity capital, infrastructure investment, or any other term that does not include, simply, money or working cash." (Decision 02-01-039, Findings of Fact 5 and 6, 2002 Cal. PUC LEXIS 5 *57.) Western Water acknowledges Park Water's and AVR's need for significant amounts of capital to invest in their water supply and delivery infrastructure and commits to meeting all of Park Water's and AVR's capital needs that the Commission has deemed necessary.

4. For financial purposes, Park Water shall maintain an equity percentage of at least 45%, on a Park-and-subsiidiaries-consolidated basis (consistent with the capital

structure used for ratemaking purposes), except to the extent the Commission imputes a lower equity percentage for ratemaking purposes.

5. Park Water and AVR will notify the Commission of any dividends and distributions to Western Water or other Affiliates in their Annual Reports to the Commission (filed on or about March 31 of each year).

6. Park Water and AVR will notify DRA and the Commission in writing of any change in corporate dividend policy within 30 days of the effective date of the adoption of such change.

7. Rate recovery of direct charges from Western Water or any other unregulated affiliates, as defined in the Affiliate Transaction Rules adopted by Decision 10-10-019 or any amendments or modifications thereto ("Affiliates") to Park Water or AVR shall be prohibited without the Commission's authorization. All such direct charges shall be specifically identified in general rate cases or advice letter filings.

8. Neither Park Water nor AVR shall issue long-term debt or guarantee any debt of any of their Affiliates without prior approval by the Commission.

9. Neither Park Water nor AVR shall sell, transfer, or encumber any utility assets necessary or useful to provide utility service, including water rights, without prior approval by the Commission.

10. Park Water and AVR shall continue to maintain their books and records in accordance with all Commission rules. Park Water's and AVR's books and records shall be maintained and be available in California.

11. The transfer of ownership and control will not adversely affect Park Water's or AVR's policies with respect to service to customers, employees, operations, financing, accounting, capitalization, rates, depreciation, maintenance, or other matters relating to the public interest or utility operations.

12. Customer service to Park Water's and AVR's customers will not be affected by the transaction. Western Water shall maintain Park Water's and AVR's commitment to high quality public utility water service and community involvement.

13. Park Water and AVR shall maintain their business headquarters in California together with fully operational local offices as appropriate to maintain the high quality of customer service and community involvement. Park Water and AVR shall not close any of its offices as a result of this transaction.

14. No additional layer of management overhead may be allocated to Park Water or AVR as a result of the transaction.

15. The proposed transaction shall not adversely affect any of the outstanding debt owed and recorded as liabilities on the regulated books of Park Water and AVR. There shall be no increase in Park Water's or AVR's cost of service or reduction in quality of service due to effects of the proposed transaction on the income statement, balance sheet or financial position of Park Water or AVR.

16. The ratepayers of Park Water and AVR shall not incur, directly or indirectly, any transaction costs or other liabilities or obligations arising from the proposed transaction. In particular, any expenses incurred by Park Water or AVR due to

the proposed transaction or the related Commission proceeding, A. 11-01-019 (such as outside legal expense and travel costs) shall be accounted for as non-utility expense and shall not be included in the recorded base of any account included in the calculation of revenue requirement for future rate cases.

17. The payroll and active-employee payroll-related costs associated with the President (Henry H. Wheeler, Jr.) and the Assistant Corporate Secretary (Chayre M. Wheeler), who will retire as a result of completion of the transaction, will not be included in the ratemaking expenses for Park Water's General Office nor will any direct charges or allocations of those costs be included in the ratemaking expenses of Park Water's operating divisions or utility subsidiaries, including AVR. The payroll-related costs to be excluded are workers' compensation insurance, payroll taxes, and associated active-employee benefits. (As neither Mr. nor Ms. Wheeler is eligible for Pension benefits or has ever participated in the 401(k) plan, there are no costs for these categories; as Mr. and Ms. Wheeler are fully vested in Park Water's Post-retirement Benefits Other than Pension ("PBOP") plan, their retirement does not affect Park Water's PBOP cost.)

18. The amount of Board of Director Fees to be recognized as utility expense in calculating revenue requirement for ratemaking purposes will be set at \$100,000 (in 2012 dollars) per year for the period 2012-2014. This amount will be included in the Park Water General Office expenses, which are allocated to Park Water's operating divisions and utility subsidiaries, including AVR.

19. Consulting fees incurred by Park Water under any consulting agreement or arrangement with Henry H. Wheeler, Jr. will be recognized as utility expense in

calculating revenue requirement for ratemaking purposes in the amount of \$63,000 (in 2012 dollars) for 2012 and 2013 and zero in 2014. Specifically, \$63,000 will be added to the expenses otherwise estimated in the Park Water General Office "Outside Services Expense" category for test year 2012, prior to allocation to AVR. In 2014, \$63,000 (in 2012 dollars) will be deducted from the adopted 2013 Outside Services expense prior to applying the appropriate escalation factor to arrive at the 2014 expense in the escalation year filing.

20. In future General Rate Increase applications for Park Water or AVR, those companies agree to specifically identify any consulting fees contained in the historic expenses incurred under any consulting agreement or arrangement with Henry H. Wheeler, Jr. so that DRA will have the information to propose any adjustment it may consider appropriate.

21. As part of this proceeding, the ratepayers of Park Water and AVR shall not incur financial obligations due to any premium paid by the purchasing Applicants for the acquisition of Park Water or AVR.

22. Park Water and AVR shall not incur any additional indebtedness, issue any additional securities, or pledge any assets to finance any part of the proposed transaction.

23. Affiliates of Park Water shall take no actions that would impair Park Water's or AVR's ability to fulfill their public utility obligations to serve and to operate in a prudent and efficient manner.

24. Any activities or actions directed at enhancing or increasing Western Water's investment in Park Water will require Commission approval for reflection of such investment in rates.

25. Any loans made to Park Water by Mr. Henry H. Wheeler, Jr. will be at prevailing market rates or lower and will be subject to prior Commission approval.

26. Affiliates of Park Water, including Western Water, shall not require Park Water or AVR to take any action inconsistent with AVR's rights under the terms of the Mojave Basin Adjudication (*City of Barstow v. City of Adelanto*, Riverside Superior Court Case No. 208568) and the Judgment After Trial, entered January 10, 1996, as amended December 5, 2002, in that case.

27. Park Water and AVR, and Western Water as the parent of Park Water, shall comply with the Affiliate Transaction Rules adopted by the Commission in Rulemaking 09-04-012, the Commission Rulemaking to develop standard rules for affiliate transactions and the use of regulated assets for non-tariffed services of water utilities.

28. The Joint Applicants shall each file written notice with the Commission of their agreement, evidenced by a duly authenticated resolution of their respective Boards of Directors, Board of Managers or the equivalent authority, to the Conditions of Approval of the Proposed Transaction set forth in this Appendix A.