PROPOSED RESOLUTION

AGENDA ID #14945 (Rev.1)
Item #4

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

DIVISION OF WATER AND AUDITS **RESOLUTION W-5069**
Water Division **July 14, 2016**

RESOLUTION

(RES. W-5069) RESOLUTION CONDITIONALLY GRANTING SPRECKELS WATER COMPANY AUTHORITY TO PROSPECTIVELY INCREASE ITS OTHER PAID IN CAPITAL BY $3,906,696, UPON SPRECKELS WATER COMPANY SUBMITTING AN AMMENDED 2015 ANNUAL REPORT, PAYING THE FEES REQUIRED BY PUBLIC UTILITIES CODE SECTION 1904.1, AND PAYING A FINE OF $5,000 FOR VIOLATING PUBLIC UTILITIES CODE SECTION 818

SUMMARY

This Resolution authorizes Spreckels Water Company (SWC) to increase its Other Paid-In Capital (OPIC) by $3,906,696, to a total of $4,115,696.[1] We grant this approval on a prospective basis only, and conditioned upon SWC: (1) amending its 2015 Annual Report to comply with Decision 07-09-005 and the Commission's Uniform System of Accounts for Class B-D Water Utilities; (2) paying a $5,000 fine within 30 days after the effective date of this resolution for violating Public Utility Code Section 818; and (3) paying the $4,907 fee required pursuant to Section 1904.1, also within 30 days of the effective date of this resolution.[2] This Resolution makes no findings as to the reasonableness of the plant additions constructed with the funds at issue in this Resolution or SWC's ability to ultimately recover these costs in rates.

It is clear that SWC violated § 818 by entering into $4,040,000 of long-term debt and equity investments without Commission approval. Pursuant to § 825, unauthorized debt and equity securities are void. By AL No. 22, SWC seeks to rectify the violations by requesting authority pursuant to §§ 816 through 851, and increase its Other Paid-In

[1] As shown in Table 1 herein, SWC's recorded OPIC was adjusted to comply with D.07-09-005 and the Commission's Uniform System of Accounts.
[2] All statutory references are to the Public Utilities Code unless otherwise indicated.

Capital (OPIC) to a total of $4,249,000. For the reasons described below, we grant SWC conditional, prospective authority to record a total of $4,115,696 in its OPIC, subject to a future review of the reasonableness of SWC's plant addition costs.

BACKGROUND

SWC is a Class D water utility subject to the jurisdiction of this Commission. SWC operates in the unincorporated community of Spreckels, located 4-1/2 mile southwest of Salinas, Monterey County. The water system serves 327 active metered customers. Since 2007, SWC has been owned and operated by Tanimura & Antle Supply Company, Inc. (TASCO).[3] TASCO is a California corporation providing agricultural services and products in the Salinas area and a wholly owned subsidiary of Tanimura & Antle, Inc. (TAI).

A. Advice Letter Request

In AL No. 22, submitted on September 1, 2015, SWC indicated that it recently became aware that debt and capital instruments require pre-approval from the Commission. Thus, in AL No. 22, SWC seeks approval from the Commission for past actions where SWC's parent company funded significant capital expenditures for SWC. Since 2008, SWC has incurred $4,040,000 of long-term debt and equity infusions via an Intercompany Account with TAI without obtaining the Commission's approval. For example, in July 2015, prior to submitting AL No. 22, SWC added $2,289,898.82 of funds to its OPIC to pay for previous capital improvements and to fund a new well that it is constructing in 2015 and 2016. By AL 22, SWC requests authority to bring its total OPIC to $4,249,000.

B. Correcting Journal Entries

SWC began producing accounting errors immediately upon its acquisition by TASCO. In D.07-09-005, the Commission required that the acquisition of SWC be accounted for at original cost for its ratebase. When TASCO acquired SWC, SWC failed to account for the acquisition at original cost and instead based its ratebase on the price of the acquisition. Subsequent to the acquisition, SWC received Contributions in Aid of

[3] See D. 07-09-005, September 6, 2007, which authorized TASCO's purchase of 100% of SWC's stock.

Construction and failed to record them on SWC's books. This year staff developed correcting journal entries to properly record the acquisition and the Contributions in Aid of Construction.[4] SWC has now recorded these adjustments on its books, resolving these accounting issues.

SWC's 2015 annual report needs to be corrected to reflect the accounting corrections. SWC also made errors on its 2015 Income Statement by incorrectly reporting certain expenses and its net loss. SWC should submit an amended 2015 Annual Report to reflect the correcting journal entries and the corrections to its income statement.

C. Funds Provided by TASCO or TAI

Each year beginning in 2007, through unauthorized loans or unauthorized equity investments, TASCO and/or TAI have been providing funds to SWC. SWC did not acquire Commission approval before it increased its debt or Other Paid In Capital (OPIC) with these funds.

Since the acquisition by TASCO, SWC has been using an Intercompany Account provided by TASCO and/or TAI, at zero percent interest, to record SWC's revenue and for TASCO/TAI to pay SWC's bills. Initially, SWC recorded the balance in the Intercompany Account under current liabilities. Starting in 2010, without Commission authorization, SWC recorded the Intercompany Account as long-term debt. TASCO and/or TAI also made unauthorized equity investments, which SWC recorded as OPIC. In 2015, TASCO and/or TAI paid off SWC's unauthorized debt, using a substantial unauthorized equity infusion in the form of OPIC.[5] The following table shows the unauthorized debt and the unauthorized equity increases by year from SWC's annual reports, consistent with the correcting journal entries.

[4] See Appendix A for the correcting journal entries up through December 31, 2015 and Appendix B for the correcting journal entries from January 1, 2016 through April 23, 2016.
[5] Since SWC indicated that it used some of the unauthorized OPIC increase in 2015 to refund its unauthorized long-term debt, the balance of the unauthorized debt at December 31, 2015 was zero.

Table 1
Unauthorized Debt and Equity

Year	Current Liabilities at December 31	Unauthorized Long-Term Debt at December 31	Unauthorized Increase in Additional Paid in Capital
2008	$ 75,630		
2009	$245,699		
2010	$ 9,604	$610,511	
2011[1]	$ 0	$129,979	$1,501,101
2012	$ 3,501	$772,455	249,000
2013	$ 4,285	$856,694	0
2014	$ 6,299	$976,395	0
2015	$ 5,714	$ 0	2,289,899
Total Reported Unauthorized OPIC			$4,040,000
2016	Correcting Journal Entries[2]		(133,304)
Total Corrected Unauthorized OPIC			**$3,906,696**

Notes: [1] In its Annual Report, SWC reported the total addition to OPIC as $1,710,101. However, in 2011, to properly reflect the amount stated on its Stock Certificate, SWC reclassified $249,000 from its Common Stock to OPIC. $209,000 of the reclassification relates to the acquisition of SWC in 2007 and is not reflected in the amount shown for 2011 in the table above as unauthorized. ($210,000 purchase price - $1,000 Stock Value = $209,000 OPIC related to the acquisition. $1,710,101 Reported OPIC - $209,000 OPIC related to Acquisition = $1,501,101 2011 OPIC increase).

[2] In March, 2016, Staff sent SWC correcting journal entries to properly reflect the acquisition in 2007, plant balances at original cost, and contributed plant.

D. Capital Improvements

SWC has made approximately $3,960,104 in plant additions, which have not been reviewed by the Commission for reasonableness. The plant additions, as corrected by the adjusting journal entries, include a main replacement program and the addition of a well, as shown in the following table:

Table 2
Additions
2007 – 2016

Year	Description	Additions
2007	Meters	$ 1,100
2008	Other Equipment	8,934
2009	Wells, Water Mains, Other Equipment	134,712
2010	Meters, Other Equipment	421,522
2011	Water Mains, Meters, Other Equipment	153,044
2012	Wells, Water Mains	1,407,514
2013	Wells	153,176
2014	Water Mains	281,202
2015/2016	Estimate for New Well	1,400,000
2016 Adjusting Journal Entries [1]		(1,100)
Total		**$3,960,104**

Notes: [1] SWC incorrectly reported an addition in 2007 of $1,100. This amount was actually a Contribution in Aid of Construction and this amount was reclassified as such by the correcting journal entries in 2016.

E. Construction of a new well

According to AL 22, SWC is building a new well to serve its customers. SWC's Well #4 construction plans include leasing the land under its new well from its parent company. In D.07-09-005, the Commission found that SWC should own the land under its wells and required a grant deed be given to SWC for the land.

Table 3
New Well Construction Budget 2015 and 2016

Item	2015	2016	Total
Install Well	$259,000	$200,000	$459,000.00
Test Hole & Monitoring	120,000	0	120,000
Records & Submittals	1,500	0	1,500
Mobilization/Demo/Clearing/Earthwork	2,500	0	2,500
Install Vertical Turbine	90,000	0	90,000
Install Pump Pedestal	5,000	0	5,000
Install 10,000 Gallon Hydropneumatic Tank	60,000	0	60,000
Install 500 Diesel Tank w/Foundation	10,000	0	10,000
Install Generator w/Foundation	80,000	0	80,000
Aboveground Station Piping	30,000	0	30,000
Electrical New Service	200,000	0	200,000
Electrical PG&E Service Costs	20,000	0	20,000
12" C900 Pipeline from Well to System	7,200	0	7,200
18" RCP Storm Drain Well to Drainage Canal	12,000	0	12,000
36" Overboard Drain Box	0	12,000	12,000
Chlorination Facilities	0	25,000	25,000
Painting, Fencing & Gravel Site	0	40,000	40,000
Performance Testing and Disinfection	0	2,500	2,500
Site Clean Up	0	1,000	1,000
Construction Contingency	0	117,770	117,770
Engineering- Well Testing & Evaluation	47,000	0	47,000
Engineering for Pump Station & Pipeline	30,000	0	30,000
Engineering/Survey Parcel and Land Split Map	5,000	0	5,000
CEQA & Permitting	10,000	0	10,000
Construction Inspection & Administration	0	35,000	35,000
Total	$989,200	$433,270	$1,422,470

F. Financial Information

In its Year 2015 Annual Report, SWC reported that it generated total operating revenues of $289,999 and a net loss of $109,284.[6] SWC's 2015 reported balance sheet is summarized and shown in the following table.

Table 4
Balance Sheet
As of 12/31/15[7]

Assets	Amount
Net Utility Plant	$1,914,863
Water Plant Construction Work in Progress	908,039
Cash	59,315
Accounts Receivable – Customers	28,706
Receivables from Associated Companies	546,676
Total Assets	$3,457,599
Liabilities & Equity	
Common Stock	$ 1,000
Other Paid-in Capital	4,249,000
Retained Earnings	(798,115)
Long-Term Debt	0
Current Liabilities	5,714
Total Liabilities & Equity	$3,457,599

G. Cash Requirements Forecast

SWC provided the following Cash Requirements Forecast with its AL 22.

[6] In its Annual Report on 2015, SWC reported a net loss of $105,496 on Schedule F, the Income Statement. This results in a discrepancy with respect to its reported Retained Earnings. SWC explained that it had under reported some expenses on its Income Statement and its actual net loss was $109,284.

[7] As reported in its Annual Report on 2015 and not adjusted by the correcting journal entries that staff issued in 2016.

Table 5
Cash Requirements Forecast

	2015	2016	Total
Funds for Well Construction	$989,200	$433,270	$1,422,470
Retirement of Bonds and Notes	0	0	0
Payment on Short-term Debt	0	0	0
Total Cash Requirements	$989,200	$433,270	$1,422,470
Less: Estimated Cash from Internal Sources	60,000	60,000	120,000
Funds Required from External Sources	**$929,200**	**$373,270**	**$1,302,470**

H. Capital Structure

SWC's capital structure as recorded as of December 31, 2015, and adjusted to give pro-forma effect to the proposed transactions in SWC's advice letter, is shown in the following table:

Table 6
Pro-forma Capital Structure

	2014 Recorded		Adjustment	Corrections	2015 Pro-forma	
Long-term Debt	$ 976,395	43.44%	($ 976,395)(A)		$ 0	0.00%
Common Stock	1,000	0.04%	0		1,000	0.03%
Other Paid In Capital	1,959,101	87.16%	2,289,899(B)	($133,304)(D)	4,115,696	120.55%
Retained Earnings	(688,830)	(30.64%)	(109,284)(C)	$95,673(D)	(702,441)	(20.57%)
Total Capitalization	$2,247,666	100.00%	$1,208,504		$3,414,255	100.00%

Notes:
(A) Payment of Intercompany Account balance of $976,395.
(B) Receipt of $2,289,899 capital from TASCO.
(C) Net loss as reported for 2015 was $105,496. SWC indicated its 2015 income statement was incorrect and the net loss should have been $109,284. However, SWC used the loss of $109,284 to calculate the change to its 2015 Retained Earnings.
(D) Correcting Journal Entries to recognize, among other things, original cost plant.

NOTICE AND PROTESTS

Pursuant to G.O. 96-B, Water Industry Rule 4.1, SWC served AL No. 22 to its service list on September 1, 2015. Notice of AL No. 22 was made by publication in the Commission's Daily Calendar of September 4, 2015. No protests have been received.

DISCUSSION

According to § 818:

> No public utility may issue stocks and stock certificates, or other evidence of interest or ownership, or bonds, notes, or other evidences of indebtedness payable at periods of more than 12 months after the date thereof unless, in addition to the other requirements of law it shall first have secured from the commission an order authorizing the issue, stating the amount thereof and the purposes to which the issue or the proceeds thereof are to be applied, and that, in the opinion of the commission, the money, property, or labor to be procured or paid for by the issue is reasonably required for the purposes specified in the order, and that, except as otherwise permitted in the order in the case of bonds, notes, or other evidences of indebtedness, such purposes are not, in whole or in part, reasonably chargeable to operating expenses or to income.

Section 823(d) states:

> No note payable at a period of not more than 12 months after the date of issuance of such note shall, in whole or in part, be refunded by any issue of stocks or stock certificates or other evidence of interest or ownership, or of bonds, notes of any term or character, or any other evidence of indebtedness, without the consent of the commission.

SWC failed to acquire Commission authorization before it entered into long-term debt in 2010, 2011, 2012, 2013 and 2014 and received unauthorized equity infusions from TASCO and/or TAI in 2011, 2012 and 2015.

Section 825 states in part that all stock and every stock certificate or other evidence of interest or ownership, and every bond, note or other evidence of indebtedness, of a public utility, issued without an order of the commission authorizing the issue thereof then in effect of not conforming in its provisions to any of the provisions which it is required by the order of authorization to contain, is void.

Pursuant to § 825, any debt or equity acquired without Commission authority is void. The Commission has no power to validate debt or equity which, under the P.U. Code, is *void ab initio*. Therefore, the Commission cannot grant SWC's advice letter request on a retroactive basis.

In addition to acquiring Commission authorization before increasing its long-term debt and/ or equity, § 817 requires that the proceeds from the issuance of the long-term debt and equity only be used for certain purposes and no others, including, but not limited to, the construction, completion, extension, or improvement of its facilities, and for the improvement or maintenance of its service. Pursuant to § 818, the proceeds may not be chargeable to operating expenses or income.

The Commission's Uniform System of Accounts, Account 211, Other Paid-in Capital (OPIC), addresses the items that SWC's OPIC account may include:[8]

A. This account shall include all paid-in-capital not derived from earnings. It shall include such items as premiums and discounts related to the issuance of capital stock, donations to the utility of its capital stock, credits arising from the forgiveness of debt of the utility, credits arising out of a reorganization of the utility, or in connection with its recapitalization.
B. Each type of paid in capital shall be carried in a separate subaccount.

As shown in Table 1, after the correcting journal entries, SWC had $3,906,696 in unauthorized and void OPIC at the end of 2015. As shown in Table 2, from 2007 through 2016, SWC will have completed approximately $3,961,204 in capital improvements, an approved purpose under § 817. It is likely that the OPIC, although unauthorized, was used for proper purposes under § 817 by either being directly used to pay for capital improvements or indirectly when the OPIC was used to retire SWC's long-term debt. However, the majority of SWC's recent additions have not been reviewed by the Commission for reasonableness. SWC's last approved rate case, Res. W-4909, found a ratebase of $839,533 to be reasonable for test year 2012.

While the Commission cannot grant a retroactive approval of the unauthorized debt and equity securities issued between 2007 and 2015, we conclude that it is reasonable to grant prospective authority for an increase to SWC's OPIC of $3,906,696 for the

[8] See D.85-04-076, page 23.

following reasons. First, there is no opposition to AL 22. Second, SWC has used the unauthorized capital infusions for plant additions, a proper purpose under § 817. Third, no informal or formal complaints have been filed against SWC during the past year. Fourth, it does not appear that the public will be harmed by the transaction. Fifth, the public may benefit from the additions to SWC's system, which will be reviewed for reasonableness in a subsequent rate case.

We deny AL 22 to the extent it requests retroactive authority for the additions of its OPIC and its previous long-term debt. Since we do not grant retroactive authority, previous transfers of funds are void for the period of time prior to the effective date of today's resolution. SWC, TASCO and TAI are at risk for any adverse consequences that may result from their having consummated the transfer of funds without Commission authorization.

OTHER MATTERS

SWC asserts that since its inception, it has been using the Intercompany Account to receive SWC's revenue, pay SWC's operating expenses and to pay for SWC's capital expenditures. Pursuant to § 818, proceeds from stocks and stock certificates, or other evidences of interest or ownership, or bonds, notes, or other evidences of indebtedness cannot be used in whole or in part, chargeable to operating expenses or income. If the unique business arrangement between SWC and TASCO or TAI with respect to an Intercompany Account should continue, SWC needs to:

1. Maintain a separate Intercompany Account for Operating Expenses and a separate Intercompany Account for Capital Expenditures.
2. Ensure that the Intercompany Account for Operating Expenses is paid off by each year end, to ensure that any of the short-term debt is not outstanding for a period of more than 12 months.
3. If SWC intends to carry a balance in the Intercompany Account for Capital Expenditures for a period exceeding 12 months, under §§ 816 through 851, it will need to request authorization from the Commission before doing so.

The Commission previously ordered that SWC operate in full compliance with Commission regulations and maintain SWC's books of accounts in accordance with the

Commission's USOA.[9] In Res. W-4909, the Commission noted that staff reclassified some of SWC's expenses to the appropriate expense categories per the USOA.[10] In staff's audit of SWC's 2013 and 2014 financial statements, staff found that SWC had recorded expenses incorrectly and that SWC needed to reclassify them. During the review of SWC's AL 22, staff evaluated SWC's plant accounting from the date of acquisition in 2007 and found numerous errors. As indicated herein, SWC was required to implement correcting journal entries because SWC failed to properly account for the acquisition, and incorrectly accounted for contributions and depreciation. In its AL 22, SWC admits that during a recent audit by Commission staff, it became aware that debt and capital instruments require pre-approval of the Commission under §§ 816 through 851 of the Public Utilities Code. SWC, and its parent company TASCO, failed to familiarize themselves with California's regulatory requirements.

While the correcting entries effect SWC's financial statements beginning in 2007, we will only require SWC to restate its most current annual report. SWC should restate and submit an amended 2015 Annual Report incorporating the correcting journal entries that staff provided to SWC, with a note that its OPIC was not authorized by the Commission. In addition, SWC should correct its 2015 income statement when it submits an amended 2015 Annual Report to reflect its actual net loss. Lastly, SWC needs to familiarize itself with California regulatory requirements and abide by them.

We will not make a finding on the reasonableness of SWC's proposed well or other additions that have not been reviewed in a general rate case. We also make no finding in this Resolution on the reasonableness of SWC's capital structure for ratemaking purposes.

PENALTY FOR VIOLATING SECTION 818

The purpose of § 818 is to enable the Commission to review proposed debt and equity transactions before they take place, in order to take such action as the public interest may require. Hence any violation of § 818, whether intentional or unintentional, is a serious offense that should be subject to fines. Such violations are subject to monetary penalties under § 826, which states as follows:

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9 See D.07-09-055, Ordering Paragraphs (OP) 3.6. and 3.3.
10 See Res. W-4909, p. 4.

> 826. Every public utility which, directly or indirectly issues or causes to be issued, any stock or stock certificate or other evidence of interest or ownership, or bond, note, or other evidence of indebtedness, in nonconformity with the order of the commission authorizing the issue, or contrary to the provisions of this part, or of the Constitution of this State, or which applies any part of the proceeds from the sale thereof, to any purpose other than the purpose or purposes specified in the commission's order or in an amount in excess of the amount authorized for a specified purpose in the order, is subject to a penalty of not less than five hundred dollars ($500), nor more than twenty thousand dollars ($20,000) for each offense.

In addition, we remind SWC that issuing debt or equity without Commission authority can have serious consequences on its officers, agents and employees as addressed by § 827, which states:

> 827. Every officer, agent, or employee of a public utility, and every other person is guilty of a felony who does any of the following acts:
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> (a) Knowingly authorizes, directs, aids in, issues, or executes, or causes to be issued or executed, any stock or stock certificate or other evidence of interest or ownership, or bond, note, or other evidence of indebtedness, in nonconformity with the order of the commission authorizing the issue, or contrary to the provisions of this part or of the Constitution of this State.
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> (b) Knowingly makes any false statement or representation in any proceeding before the commission or with knowledge of its falsity files or causes to be filed with the commission any false statement or representation which tends in any way to influence the commission to make an order authorizing the issue of any stock or stock certificate or other evidence of interest or ownership, or any bond, note, or other evidence of indebtedness, or which results in procuring from the commission the making of any such order.
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> (c) With knowledge that any false statement or representation was made to the commission, in any proceeding, tending in any way to influence the commission to make such order, issues or executes or negotiates, or

> causes to be issued, executed, or negotiated any such stock or stock certificate or other evidence of interest or ownership, or bond, note, or other evidence of indebtedness.
>
> (d) Directly or indirectly, knowingly applies, or causes or assists to be applied any part of the proceeds from the sale of any stock or stock certificate or other evidence of interest or ownership, or bond, note, or other evidence of indebtedness, to any purpose not specified in the commission's order, or to any purpose specified in the commission's order in excess of the amount authorized for such purpose.
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> (e) With knowledge that any stock or stock certificate or other evidence of interest or ownership, or bond, note, or other evidence of indebtedness, has been issued or executed in violation of any of the provisions of this part, negotiates, or causes the same to be negotiated.

The failure of SWC to procure Commission authorization before entering into long-term debt or receiving equity infusions are violations of § 818. SWC's stated reason for violating these statutory requirements is ignorance. Failure to become familiar with the rules and regulations that SWC must abide by is not a valid excuse for violations. Operating SWC in compliance with Commission regulations and maintaining SWC's books of accounts in accordance with the Commission's USOA was a condition of the approval of the transfer and SWC is subject to the laws and regulations pertinent to utilities under the Commission's jurisdiction.[11]

For the following reasons, we conclude that SWC should be fined for its failure to comply with § 818. First, any violation of § 818, regardless of the circumstances, is a serious offense that should be subject to fines. Second, the imposition of a fine will help to deter future violations of § 818 by SWC and others.

To determine the size of the fine, we rely on the criteria adopted by the Commission in D.98-12-075. In that decision, the Commission held that the size of a fine should be proportionate to the severity of the offense. To determine the severity of the offense, the Commission stated that it would consider physical harm, economic harm, harm to

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[11] See D.07-09-055, Ordering Paragraphs (OP) 3.6. and 3.3.

the regulatory process and the number and scope of violations. It is clear that a violation of § 818 prevents the Commission from reviewing debt or equity infusions before they are incurred, harming the regulatory process. SWC incurred a significant amount of debt and increases in its OPIC, which may ultimately lead to large increases to its customers' bills. However, there is no evidence that SWC benefited from its unlawful conduct, as it was not paying interest on the Intercompany Account balances.

The Commission held in D.98-12-075 that the size of a fine should reflect the conduct of the offender. SWC has repeatedly failed to familiarize itself with California regulatory requirements.

The Commission also held in D.98-12-075 that the size of the fine should reflect the financial resources of the offender. The Commission stated that it would consider the need for deterrence and constitutional limitations on excessive fines. According to the Annual Report that SWC submitted for the year ended December 31, 2015, while SWC has been operating at a net loss, SWC had operating revenues of approximately $289,999, Receivables from Associated Companies of $546,678, Cash and Customer Accounts Receivables of $88,021, and Other Current Liabilities of $5,714. We will weigh this information accordingly when setting the amount of the fine.

Finally, the Commission held in D.98-12-075 that any decision which imposes a fine should (1) address previous decisions that involve reasonable comparable factual circumstances, and (2) explain any substantial differences in outcome.

The closest, recent comparison involved Benbow Water Company (Benbow), which did not involve a fine.[12] Benbow's unauthorized loan that was a one-time occurrence was used for a plant addition that was a relatively small part of its total plant in service. Also the capital additions constructed with the unauthorized loan had already been deemed reasonable and implemented into rates in a Benbow rate case in 2003. Benbow also had a significant amount of retained earnings, $491,964, for a company of its size.

In contrast, SWC has made a considerable amount of improvements to its system, $3.9 million over the almost $98,000 in plant it had in 2007, most of which have not been evaluated in a rate case. SWC also entered into multiple large amounts of unauthorized

[12] See Resolution W-5048, dated June 26, 2015.

long-term debt or equity investments without Commission approval on a yearly basis since the transfer in 2007. SWC has a weighty balance of negative retained earnings, -$798,115, demonstrating that SWC has been operating at a loss for a considerable amount of time. Having a large negative balance in retained earnings and making a substantial amount of plant improvements that have not been considered in a rate case, exposes ratepayers to a significant rate increase when SWC does come in for a rate case.

We conclude based on the facts of this case that SWC should be fined $5,000 for violating § 818. We emphasize that the size of this fine is tailored to the unique facts and circumstances before us. We may impose larger fines in other circumstances if the facts so warrant. A larger amount would be justified if SWC or its parent company had been profiting from its violations. The facts do not demonstrate any profiteering, as SWC has been operating at a loss and interest was not charged on the long-term debt. SWC is still at risk that plant addition expenditures may not be found reasonable or recoverable in its next rate case.

SWC is cautioned that its officer, agent, or employee could be charged with a felony for any of the acts listed in § 827, including those who knowingly authorizes, directs, aids in, issues, or executes, or causes to be issued or executed, any stock or stock certificate or other evidence of interest or ownership, or bond, note, or other evidence of indebtedness, in nonconformity with §§ 816 through 851.

GENERAL ORDER 24-C

General Order (GO) 24-C requires public utilities that issue debt or equity to file a semiannual report with the Commission that includes the information specified in GO 24-C for the applicable semiannual period.

FEES

Whenever the Commission authorizes a utility to issue debt or equity, the Commission is required to charge and collect a fee in accordance with §§ 1904 or 1904.1. SWC used the Intercompany Account to pay for previous capital improvements. The fee for the

$3,906,696 of prospective OPIC as required by § 1904.1 is $4,907.[13] SWC must issue the check payable to the California Public Utilities Commission and remit the payment to the Commission's Fiscal Office.

SAFETY

In 2014, the State Water Resources Control Board (SWRCB) conducted a sanitary survey of SWC and relayed the results to SWC in a letter dated November 12, 2014. SWRCB indicated that SWC is adequately maintained and operated and all water quality samples are up to date, except where noted in the letter.

COMMENTS

Section 311(g)(1) generally requires that draft resolutions be served on all parties and subject to at least 30 days public review and comment prior to a vote of the Commission. Accordingly, this Proposed Resolution was mailed to the utility and parties in SWC's service list, and made available for public comment on June 14, 2016.

The Proposed Resolution in this matter was mailed to the parties in accordance with § 311(g)(1) and comments were allowed under Rule 14.3 of the Commission's Rules of Practice and Procedure. An inquiry as to how the increase in SWC's Other Paid in Capital would affect SWC's ratepayers was filed on June 14, 2016 by a customer. DWA informed the customer that the Proposed Resolution will put SWC in compliance with the Commission's financing and accounting requirements and other rules and regulations. Furthermore, the Proposed Resolution does not authorize any construction program nor does it approve any rate increase. The customer acknowledged DWA's explanation and no other comments were received. This customer's concern resulted in nonsubstantive changes to the Proposed Resolution.

This Resolution provides prospective authority and includes sufficient conditions and checks and balances to ensure that SWC abide by and comply with regulatory requirements.

[13] The fee assessed on $3,906,696 is as follows: $2 times ($1,000,000/$1,000) plus $1 times ($2,906,696/$1,000) equals $4,907.

FINDINGS

1. In AL No. 22, submitted on September 1, 2015, SWC requests approval for its July 2015 increase of $2,289,898.82 to its OPIC, bringing the total of its OPIC to $4,249,000.

2. The Commission's approval of the transfer of SWC in 2007, D.07-09-005, authorized an OPIC of $209,000.

3. Without the authorization of the Commission, SWC has been using an Intercompany Account whereby TAI receives SWC's revenues and pays for SWC's operating expenses and capital improvements, with balances that extend beyond 12 months.

4. In violation of § 818, SWC issued unauthorized debt obligations and received up to $4,040,000 in OPIC without prior Commission authorization.

5. In 2016, SWC implemented the adjusting journal entries initiated by DWA staff to correct SWC's acquisition and plant accounting errors.

6. SWC and its parent company were and remain unfamiliar with California regulatory requirements.

7. If SWC intends to continue using its Intercompany Account for receiving revenue and paying expenses, it must:

   a. Maintain a separate Intercompany Account for Operating Expenses and a separate Intercompany Account for Capital Expenditures.
   b. Ensure that the Intercompany Account for Operating Expenses is paid off by each year end, to ensure that any of the short-term debt is not outstanding for a period of more than 12 months.
   c. If SWC intends to carry a balance in the Intercompany Account for Capital Expenditures for a period exceeding 12 months, under §§ 816 through 851, it will need to request authorization from the Commission before doing so.

8. The primary standard used to determine if debt or equity increases should be approved under Section 818 is whether the amount is reasonably required, that the proceeds will be used for proper purposes, and that such purposes are not reasonably chargeable to operating expenses or income.

9. While SWC's capital improvements were paid with proceeds from debt and equity not authorized by the Commission, the expenditures were a proper purpose under § 817 and therefore, the public may benefit from the prospective approval of an addition to its OPIC of $3,906,696.

10. In D.98-12-075, the Commission adopted criteria for determining the amount of a fine.

11. SWC's failure to comply with § 818 did not result in actual or threatened harm to others and did not significantly benefit SWC.

CONCLUSIONS OF LAW

1. The authority granted today pursuant to §§ 816 through 851 should apply prospectively. Retroactive authority cannot be granted.

2. SWC violated § 818 by entering into long-term debt and receiving additions to its Other Paid In Capital without Commission authorization.

3. Section 826 provides the Commission with authority to impose a fine of between $500 and $20,000 on a public utility that directly or indirectly issues, or causes to be issued, any stock or stock certificate or other evidence of interest or ownership, or bond, note, or other evidence of indebtedness contrary to §§ 816 through 851.

4. The Commission does not by this Resolution determine that SWC's construction expenditures and capital structure are necessary or reasonable for ratemaking purposes. These issues are normally addressed in a general rate case.

5. In D.07-09-005, OP 3.3., the Commission ordered that SWC maintain SWC's books of accounts in accordance with the Commission's USOA.

6. In D.07-09-005, OP 3.6., the Commission ordered that SWC operate SWC in full compliance with Commission regulations.

7. It is SWC's responsibility to abide by and comply with California's regulatory requirements.

8. Applying the criteria in D.98-12-075 to the facts noted herein this resolution, demonstrates that a fine of $5,000 for violating § 818 is reasonable.

9. There is no known opposition to the filing.

10. It is reasonable to grant a prospective addition of $3,906,696 to SWC's OPIC because: a) the proceeds from the unauthorized amounts were used for proper purposes under § 817; b) no formal or informal complaints about SWC were submitted in the last year; c) the public will not be harmed by this transaction; and d) the public may benefit from the additions to SWC's system.

11. As discussed herein, the approval for prospective authority should be conditional upon:
    a) SWC submitting an amended 2015 Annual Report;
    b) SWC paying a $5,000 fine for violating § 818; and
    c) SWC paying the $4,907 fee pursuant to § 1904.1

12. Section 826 provides the Commission authority to impose a fine of between $500 and $20,000 for each violation of the Public Utilities Code.

13. In D.98-12-075, the Commission adopted the following criteria for determining the amount of a fine: (1) the severity of the offense, (2) the conduct of the offender, (3) the financial resources of the offender, (4) the totality of the circumstances, and (5) the role of precedent.

14. SWC is required to file the reports mandated by General Order 24-C.

<u>THEREFORE IT IS ORDERED THAT:</u>

1. Spreckels Water Company is authorized to add $3,906,696 to its Other Paid In Capital, bringing the total of its Other Paid In Capital to $4,115,696. The authority granted in this ordering paragraph shall be prospective only from the effective date of this order.

2. From the effective date of this Resolution, if the unique business arrangement between SWC and TASCO or TAI with respect to its Intercompany Account should continue, SWC must:

a) Maintain a separate Intercompany Account for Operating Expenses and a separate Intercompany Account for Capital Expenditures.
b) Ensure that the Intercompany Account for Operating Expenses is paid off by each year end, to ensure that any of the short-term debt is not outstanding for a period of more than 12 months.
c) If SWC intends to carry a balance in the Intercompany Account for Capital Expenditures for a period exceeding 12 months, pursuant to Public Utilities Code Sections 816 through 851, it will need to submit an advice letter to request authorization from the Commission before doing so.

3. Within 30 days of the effective date of this resolution, as discussed herein, Spreckels Water Company shall submit an amended 2015 Annual Report reflecting the correcting journal entries, corrections to its Income Statement, and a note on its 2015 Balance Sheet indicating that its Other Paid In Capital is unauthorized.

4. Spreckels Water Company shall pay a $5,000 fine for violating Public Utilities Code Sections 818 within 30 days from the effective date of this order. Spreckels Water Company shall tender to the Fiscal Office of the California Public Utilities Commission at 505 Van Ness Avenue, Room 3000, San Francisco, CA 94102, a check in the amount of $5,000 payable to the State of California General Fund. The number of this resolution shall appear on the face of the check.

5. Pursuant to Public Utilities Code § 1904.1, Spreckels Water Company shall pay the fee of $4,907 within fifteen days of the effective date of this Resolution. Spreckels Water Company must issue the check payable to the California Public Utilities Commission and remit the payment to the Commission's Fiscal Office. The number of this Resolution shall appear of the face of the check.

6. This Resolution is effective today.

I certify that the foregoing Resolution was duly introduced, passed, and adopted at a conference of the Public Utilities Commission of the State of California held on July 14, 2016. The following Commissioners approved it.

TIMOTHY J. SULLIVAN
Executive Director

APPENDIX A (1 of 2)

Spreckels Water Company
Prior Period Adjustments
As of December 31, 2015

Acct	Description	DR	CR
304	Structures	$600.04	
307	Well #2	$41,102.00	
334	Meters	$4,457.95	
335	Hydrants	$108.27	
331	Water Mains	$1,037.57	
114	Water Plant Acquisition Adjustment	$112,864.70	
307	Well #1		$39,249.30
311	Pumping Equipment		$403.49
330	Reservoirs, Tanks and Sandpipes		$8,255.77
333	Services and Meter Installations		$107,313.40
339	Other Equipment		$4,948.57
	To Adjust 2007 Acquired Plant to Original Cost Per D.07-09-005		
108	Accumulated Depreciation	$95,332.64	
215	Retained Earnings		$95,332.64
	To reverse Excess Depr Taken on 2007 PIS in 2007 and subsequent years		
215	Retained Earnings	$51,387.95	
108	Accumulated Depreciation		$51,387.95
	To recognize appropriate Depr for 2007 PIS at 2.1% for years 2007-2010 and and 2.5% per Resolution W-4909 for 2011-2014		
211	Additional Paid in Cap.	$112,864.70	
114	Water Plant Acquisition Adjustment		$112,864.70
	To recognize full amortization of Acquisition Adjustment		
211	Additional Paid in Cap.	$19,339.72	
108	Accum Depr	$10,314.72	
307	Well #22		$19,339.72
215	Retained Earnings		$10,314.72
	To reverse improperly charging SWC in 2009 for the capping of T&A Well #22; T&A owned Well #22.T&A received gain from sale to developer.		
307	Well #1	$40,000.00	
215	Retained Earnings		$40,000.00
	To reverse the overstated 2008 retirement of Well #1		

APPENDIX A (2 of 2)
Spreckels Water Company
Prior Period Adjustments
As of December 31, 2015

Acct	Description	DR	CR
108	Accumulated Depreciation	$750.00	
307	Well #1		$750.00
	To retire Well #1 Based on Original Cost Net Book Value		
307	Well #3	$750,000.00	
271.2	Depreciable Contributions in Aid of Construction		$750,000.00
	To account for contribution of Well #3 from developer; T&A Invoice #11092007, dated Nov 9, 2007		
272	Accumulated Amortization of Contributed Well #3	$150,000.00	
108	Accumulated Depreciation		$150,000.00
	To recognize amortization of Well #3, a depreciable asset, from 2008 through 2014, 40 year life, Straight-line Amortization		
303	Land under Wells #1, #2, and #3	$85,924.00	
271.1	Non-depreciable Contributions in Aid of Construction		$85,924.00
	To recognize land contributed in 2007 by Monterey County Grant Deed #2007082664; value estimated at $100,000 per acre, per SWC email to Ms. Sligh, dated Nov 18, 2015, Not to be amortized to USOA Account #272		
211	Additional Paid in Capital	$1,100.00	
108	Accumulated Depreciation	$1,100.00	
339	Other Equipment		$1,100.00
	Retained Earnings		$1,100.00
	To reverse meters incorrectly booked to Other Equipment and that were contributed by developer per SWC email dated Nov 30, 2015		
334	Meters	$1,600.00	
272	Accumulated Amortization of Contributed Meters	$1,600.00	
271.2	Depreciable Contributions in Aid of Construction		$1,600.00
108	Accumulated Depreciation		$1,600.00
	To recognize meters contributed by developer per SWC email, dated Nov 30, 2015, and amortization at depr rates used by SWC for meters		

APPENDIX B

Spreckels Water Company
Prior Period Adjustments
To Comply with D.07-09-005 and Recognize Contributions and Approved Depreciation Rates
January 1, 2016 through April 23, 2016

Acct	Description	DR	CR
108	Accumulated Depreciation	$2,458.93	
215	Retained Earnings		$2,458.93
	To reverse Excess Depr Taken on 2007 PIS in 2007		
108	Accumulated Depreciation	$297.54	
215	Retained Earnings		$297.54
	To reverse Depreciation related to T&A Well #22 T&A owned Well #22 per Nov 30, 2015 Varney email and T&A received gain from sale to developer (T&A Invoice #11092007, dated Nov 9, 2007)		

Spreckels Water Company Advice Letter # 22
Service List
September 1, 2015

Overnight Mail Recipients:

California Public Utilities
Commission
Division of Water and Audits
505 Van Ness Avenue
San Francisco, CA 94102-3298

Email Recipients:

California Public Utilities
Commission
Division of Water and Audits
water_division@cpuc.ca.gov

Kerry L. Varney
Spreckels Water Company
Kerry@taproduce.com

Stephen Bachman
Sbachman123@gmail.com

Michael L. Jones
California Water Service Co.
mjones@calwater.com

US Mail Recipients:

Craig Anthony
California-American Water Co.
511 Forest Lodge Road, Suite 100
Pacific Grove, CA 93950

Michael L. Jones
District Manager – Salinas & King
City
California Water Service Co.
254 Commission Street
Salinas, CA 93901

David Stephenson
California American Water Company
4701 Beloit Drive
Sacramento, CA 95838

Sarah Gnat
Spreckels Community Services
District
P.O. Box 7432
Spreckels, CA 93962

Clerk to the Board
Monterey County Board of
Supervisors
168 West Alisal Street, 1st Floor
Salinas, CA 93901

Jan Sweigart
California Department of Health
Services
#1 Lower Ragsdale Drive, Suite 120
Monterey, CA 93940

Luciano and Julita Galleguillos
P.O. Box 7338
Spreckels, CA 93962

Larry Williams
99 – 2nd Street
Spreckels, CA 93908

Ken Dursa
145 Harvest Street
Salinas, CA 93901

Ron Eastwood
P.O. Box 7381
Spreckels, CA 93962