

WATER/KPC/FLC/KOK/RHG

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

**WATER DIVISION
AUDIT AND COMPLIANCE BRANCH**

**RESOLUTION W-4541
June 16, 2005**

R E S O L U T I O N

RESOLUTION W-4541. HAVASU WATER COMPANY (HAVASU). REQUEST FOR AUTHORITY TO ISSUE 15,000 SHARES OF COMMON STOCK, \$1.00 PAR VALUE, THE PROCEEDS OF WHICH WILL BE USED FOR SYSTEM IMPROVEMENTS AND OPERATING CAPITAL.

By Advice Letter (AL) No. 31 filed on March 24, 2005.

SUMMARY

Pursuant to Article 5, Stocks and Security Transactions of the Pub. Util. Code¹, this Resolution authorizes Havasu to issue 15,000 shares of Common Stock, \$1.00 par value at \$10.00 per share or a total of \$150,000 . The proceeds of the equity issue will be used for system improvements and capital expenditures.

Notice of AL No. 31 was made by publication in the Commission’s Daily Calendar of March 30, 2005. No protests have been received.

BACKGROUND

Havasu, a California corporation, is a Class D water utility subject to the jurisdiction of this Commission. Havasu provides water to 205 mobile homes and other residences, all on legal, individual subdivided lots in an area located near Havasu Landing, approximately 40 miles southeast of Needles, San Bernardino County.

¹ All statutory references are to the Public Utilities Code unless otherwise indicated.

Pursuant to its Year 2004 Annual Report, Havasu reported that it generated total operating revenues of \$151,659 and net income of \$36,400.

The company's balance sheet is summarized below:

<u>Assets</u>	<u>Amount</u>
Net Utility Plant	\$ 199,129
Other Investments	16,876
Current Assets	96,734
Other Current Assets	<u>23,046</u>
Total Assets	<u>\$ 335,785</u>
<u>Liabilities & Equity</u>	
Stock	\$ 218,491
Donated Capital	422,577
Retained Earnings	-442,168
Long-Term Debt	89,500
Current and Accrued Liabilities	<u>47,385</u>
Total Liabilities & Equity	<u>\$ 335,785</u>

DISCUSSION

Havasu presently has an inadequate fire flow supply (some of the fire hydrants deliver only 300 gallons per minute). Havasu proposes to add and install fire pump equipment, construct a building to house the pump, and run approximately 2,000 feet of pipe to connect into the system, and carry the back flush water from the filtration plant to a disposal pond. The proposed pump and water mains will produce 1,500 gpm that will provide adequate supply and meet minimum county requirements.

Havasu's present rate schedule for water service was authorized in Advice Letter No. 28 effective May 21, 2003, pursuant to Resolution W-4395, whereby the utility was granted a rate base offset and cost of living rate increase producing additional revenue of \$16,304 or 13.44%.

A. Construction Budget

Havasu’s estimated construction costs are as follows:

Horizontal Diesel Fire Pump (2000 GPM at 50 PSI)	\$ 41,000
Concrete slab and building enclosure	4,000
Labor	1,250
2,000 feet of pipe, gate valves, kick blocks, trenching, backfill, water flooding, compaction, repavement, and two fire hydrants	50,000
Contingency	<u>5,000</u>
Total	<u>\$100,250</u>

B. Operating Capital

Havasu proposes to use approximately \$50,000 of the equity issue for operating capital.

Havasu’s current financial condition will not permit it to undertake the project without the infusion of cash from an equity offering. Havasu has negative retained earnings of \$442,168.

Because of its weak financial position that may threaten its ability to deliver clean, safe, and reliable drinking water to its customers, we will order Havasu to request, within one hundred eighty days of this order, for authority to increase rates using the advice letter process.

C. Proposed Issue of Shares of Common Stock

AL No. 31 states that in accordance with the California Corporations Code Section 307(b), Havasu amended its articles of incorporation on January 18, 2005, and the directors and shareholders voted to increase the authorized number of shares of common stock from 25,000 to 125,000. Havasu's present capital is distributed as follows:

E.L. Hodges	15,266 shares
W.R.Holcomb	12,396 shares
Energy Production & Sales Co. (EPS)	<u>3,328 shares</u>
Total	<u>30,990 shares²</u>

E.L. Hodges Trust³ will acquire 9,000 shares of the proposed 15,000 shares of Common Stock at a selling price of \$10.00 per share. Havasu states in its letter dated May 9, 2005, that it has not decided to whom to offer the remaining 6,000 shares.

E.L. Hodges will remain the major stockholder and will continue to hold the controlling interest in Havasu.

D. Use of Proceeds

The estimated proceeds of \$150,000 from the equity securities will be used for the following: \$100,000 for the purchase and installation of a diesel fire pump, a building to house the pump, 10" connector main to existing facilities, and a backwash water disposal pipe; \$50,000 is being allocated for operating capital.

Section 816 provides that the power of public utilities to issue stocks and stock certificates or other evidence of interest or ownership and bonds, notes, and other evidences of indebtedness and to create liens on their property situated within the State is a special privilege, the right of supervision, regulation, restriction, and control of which is vested in the State, and such power shall be exercised as provided by law under such rules as the commission prescribes.

² An additional \$100,000 has been received by Havasu as an advance. Stock has yet to be issued.

³ A living trust for E.L. Hodges' personal assets.

A utility may amend its articles of incorporation to provide for an increase of its authorized stock without the authorization of the commission, but no stock may be issued under the amended articles without an order. A public utility is therefore required under Section 816 to obtain Commission's authorization for the issuance of stock.

Section 817 allows a utility, among others, to issue stocks for the acquisition of property, for the construction, completion, extension, or improvement of its facilities, and for the improvement and maintenance of its service.

Section 818 states that 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.

Havasu and its common stockholders are placed on notice that the Commission does not regard the number of shares outstanding, the total book value of these shares or the dividends paid as measuring the return Havasu should be permitted to earn on its investment in plant. Our authorization is not to be construed as a finding of the value of Havasu's stock or properties nor as indicative of the amounts to be included in proceedings for the determination of just and reasonable rates.

Havasu should also comply with other requirements of law in reference to the increase of its authorized number of shares of common stock and the amendment of its articles of incorporation.

Section 817 provides that a utility cannot claim the privilege of capitalizing operating expenses and the cost of maintaining service as a matter of right. While the Commission does not look with favor upon the capitalization of operating expenses and the cost of maintaining service, it has the power

and will, in extraordinary cases, authorize securities for that purpose. In D.91-05-021 dated May 8, 1991 in A.90-12-071, the Commission authorized Valencia Water Company to obtain a \$15,000,000 line of credit for, among other purposes, working capital requirements (to cover existing current obligations).

For proper cause, § 818 allows upon order of the Commission, the use of proceeds for purposes reasonably required in the operation of a utility, including operating capital. We will permit Havasu to use approximately \$50,000 of the debt authorized herein for operating capital. Our authorization pertains only to this proceeding. It is the exception rather than the rule. Pursuant to § 818, we will approve Havasu's proposed issue of 15,000 shares of Common Stock at \$10.00 per share.

We have observed while reviewing Havasu's years 2000 through 2004 annual reports to the Commission that the utility procured several long-term debts from its shareholders to cover operating deficiencies. As of 2004, Havasu reported a balance of \$89,500 owed to EPS. We have no record of having approved any of the loans extended to Havasu by shareholders. Havasu may have unintentionally violated Commission requirements by failing to seek authorization for certain long-term debts.

We encourage Havasu to verify any outstanding long-term debt entered into by it without intent to violate or issued in ignorance of the Public Utilities Code and by a separate filing, request Commission authority to issue new notes in lieu of those executed without permission.

We remind Havasu of the provision of § 825:

All stock and every stock certificate or other evidence of 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 or not conforming in its provisions to any of the provisions which it is required by the order of authorization to contain, is void. No failure in any other respect to comply with the terms or conditions of the order of authorization of the commission shall render void any stock or stock certificate or other evidence of interest or ownership, or any bond, note, or other evidence of indebtedness, except as to a corporation or person

taking it otherwise than in good faith and for value and without actual notice.

Although Havasu filed AL No. 31 on March 24, 2005, inquiries regarding the funding of the proposed system improvements have been going on since December 2004. There is no opposition to Havasu's filing and there is no reason to delay granting the authority requested.

The fee for this financing authority as set forth by § 1904(b) is \$300⁴.

This is an uncontested matter in which the Resolution pertains solely to a water company. Accordingly, pursuant to Pub. Util. Code § 311(g)(3), the 30-day period for public review and comment under § 311(g)(1) does not apply.

FINDINGS

1. Havasu needs external funds for the purposes set forth in the filing.
2. The proposed issuance of shares of Common Stock is for lawful purposes and the money, property, or labor to be procured or paid for by them is reasonably required for these purposes.
3. The number of shares outstanding, the total par value of the shares, and any dividends that will be paid do not determine allowable return on plant investment. This authorization is not a finding of the value of Havasu's stock or property, nor does it indicate the amount to be included in ratemaking proceedings.
4. Havasu should comply with any requirements of law in reference to the increase of its authorized number of shares of common stock and the amendment of its articles of incorporation.
5. Havasu should request authority for a general rate increase.
6. Havasu may have unintentionally violated Commission requirements by failing to seek authorization for certain outstanding long-term debts.

⁴ The amount subject to the fee is \$150,000. The fee is determined as follows: $(\$2 \times (150,000/1,000)) = \300.00 .

7. Havasu should pay the fee determined in accordance with § 1904(b).

THEREFORE, IT IS ORDERED THAT:

1. Havasu Water Company on or after the effective date of this order is authorized to issue up to 15,000 shares of Common Stock, \$1.00 par value at \$10.00 per share; and to use the proceeds for the purposes specified in Advice Letter No. 31.
2. Havasu shall notify the Water Division in writing when the project has been completed.
3. Havasu Water Company shall upon completion of the project provide the Water Division a summary detailing the receipts and disbursements related to this order.
4. Havasu Water Company shall notify the Water Division in writing when the stock certificates are issued, including the name of shareholder and number of stocks received within thirty days of issuance.
5. Havasu shall review its outstanding long-term debts and as applicable, by the advice letter procedure request Commission authority to issue new notes for outstanding debt issues executed without permission.
6. Havasu Water Company shall file for authority for a general rate increase by an advice letter filing within one hundred eighty days from the effective date of this order. The filing will be subject to reasonableness review.

7. The authority granted by this order shall become effective when Havasu Water Company pays \$300, the fee set forth by Public Utilities Code §1904(b).

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 _____. The following Commissioners approved it: