

WATER/RSK/KOK/DLW/RHG

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

**DIVISION OF WATER AND AUDITS
UTILITY AUDIT, FINANCE AND
COMPLIANCE BRANCH**

**RESOLUTION W-4800
OCTOBER 29, 2009**

R E S O L U T I O N

RESOLUTION W-4800. RESOLUTION GRANTING BASS LAKE WATER COMPANY AUTHORITY TO BORROW THE TOTAL AMOUNT OF \$588,660 FROM PLUMAS BANK AND TO ENCUMBER ITS ASSETS IN CONNECTION WITH THE DEBT.

By Advice Letter No. 53-W filed on July 2, 2009.

SUMMARY

This Resolution grants Bass Lake Water Company (BLWC) the authority requested in Advice Letter (AL) 53-W.

BLWC requests authority, pursuant to §§ 816 through 851 of the Public Utilities Code, to enter into two loan agreements, not exceeding a total of \$588,660, from the Plumas Bank (Bank), and to encumber its assets to secure the debt.¹ The proceeds of the loans will be used to pay The Pines Resorts of California, LLC (Pines Resort), BLWC's parent company, for funds advanced to BLWC that were used for BLWC's capital improvements.

NOTICE AND PROTESTS

Notice of AL 53-W was made by publication in the Commission's Daily Calendar of July 3, 2009. No protests have been received.

BACKGROUND

BLWC, a California corporation, is a Class C water utility subject to the jurisdiction of this Commission. BLWC provides service to 103 metered and 951 flat-rate customers in the northwest shore of Bass Lake, including the Falls and Bass Lake and vicinity, Madera County.

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

In its Income Statement for the year ending December 31, 2008, BLWC reported that it generated total operating revenues of \$587,519 and a net loss of \$20,868. BLWC's Balance Sheet, as of December 31, 2008, as reported, is summarized below:

Table 1
Balance Sheet as of December 31, 2008

<u>Assets</u>	<u>Amount</u>
Net Utility Plant	\$1,742,289
Investments	-
Current & Accrued Assets	<u>462,816</u>
Total Assets	<u>\$2,205,105</u>
<u>Liabilities & Equity</u>	
Common Stock	\$ 49,100
Other Paid-in Capital	1,030,900
Retained Earnings	(559,505)
Long-Term Debt	148,446
Advances from Associated Companies	776,937
Current & Accrued Liabilities	71,795
Advances for Construction	385,476
Other Credits	<u>301,956</u>
Total Liabilities & Equity	<u>\$2,205,105</u>

The last general rate increase of BLWC was authorized in Resolution (Res.) W-4544, dated June 30, 2005. A CPI-U increase of 4.1% for 2007 became effective December 1, 2008.

In Res. W-4741, dated February 20, 2009, the Commission granted BLWC an increase in gross annual revenues of \$122,648 or 24.35% to provide a return on rate base for capital projects of \$694,397 for plant additions made during the years 2004 through 2008. In Res. W-4741, the Commission states that the Division of Water and Audits (DWA) reviewed and confirmed that the following plant additions have been completed and are used and useful.

Table 2
BLWC Plant Additions Confirmed in Res. W-4741

<u>Year of Plant Addition</u>	<u>Description</u>	<u>Amount</u>
2004	A new chlorine room with pumping equipment and a panel system, well vault, piping, and meter for Pines Well One location.	\$ 53,219
2005	Services and meter installation in Willow Cove, booster pumps and a new truck.	33,976
2006	Replacement of mains, 21 new service connections, a new fire hydrant, and rebuilding the engine on a bobcat.	67,406
2007	Pumping equipment for the School Road Well, water main replacement and two chlorine analyzers.	54,554
2008	Replacement of undersized distribution mains, installation of two new fire hydrants, 18 new service connections, and a main line replacement in Road No. 22	485,242
	Total	<u>\$694,397</u>

A. Unauthorized Advances and Line of Credit

According to BLWC, Pines Resorts began advancing funds to BLWC in 2002 for BLWC to use for its construction projects. However, BLWC and Pines Resorts did not formally document any of the advances until 2008. According to BLWC, Pines Resorts advanced \$776,937 beginning in 2002 and continuing through 2008.

On May 8, 2008, BLWC entered into a Line-of-Credit Agreement with Pines Resorts in the amount of \$500,000, at a variable rate equal to the national prime interest rate payable and compounded monthly on the unpaid balance until June 30, 2009. The agreement states that if an unpaid balance remains after June 30, 2009, interest on the unpaid balance shall be payable and compounded quarterly commencing July 1, 2009.

BLWC did not obtain Commission approval for either the advances or the Line-of-Credit Agreement.

B. Loan A and Use of Proceeds

In AL 53-W, BLWC requests authority to enter into two loan agreements, Loan A and Loan B.

BLWC requests that the principal amount of Loan A be \$344,593, with a fixed term of 10 years and an annual interest rate of 6.50%. BLWC estimates the annual principal and interest payment will be \$47,481.12.

Between 2002 and 2007, BLWC indicates that it undertook the following plant improvements, in Table 3, that it asserts that it funded through advances from Pines Resorts. According to BLWC, the proceeds of Loan A are to be used to liquidate 85% of the advances used for these capital improvements, and convert the remainder, \$60,810, or 15%, booked as paid-in-capital.

Table 3
2002 through 2007 Improvements Funded by Advances per BLWC

<u>Year of Plant Addition</u>	<u>Description</u>	<u>Cost</u>	<u>Total</u>
2002 to 2003	North Shore Road main distribution line, services, fire hydrants	\$282,702.96	\$282,702.96
2004	Pines Maintenance Shop service	10,891.79	
	New chlorine room at treatment plant	<u>6,093.40</u>	16,985.19
2005	Main line replacement at end of Willow Cove (to Feece residence)	7,250.00	
	New services on Willow Cove	<u>10,556.00</u>	17,806.00
2006	Main line and services on Mono main	17,799.95	
	Main line on Island	27,205.37	
	Main line and services on Spur	14,040.94	
	Fire hydrants on Spur and Island	<u>1,425.30</u>	60,471.56
2007	Main line replacement on Fir & Alder	27,438.15	<u>27,438.15</u>
	Total Plant Improvements		<u>\$405,403.86</u>

Pursuant to BLWC's 2002 and 2003 annual reports submitted to the Commission, BLWC reported the following plant additions of \$336,361 in those years.

Table 4
2002 and 2003 Improvements per BLWC Annual Report

<u>Plant Additions</u>	<u>2002</u>	<u>2003</u>	<u>Total</u>
Water mains	\$247,477	\$ 0	\$247,477
Service & meter installations	60,349	13,066	73,415
Hydrants	<u>15,469</u>	<u>0</u>	<u>15,469</u>
Total	<u>\$323,295</u>	<u>\$13,066</u>	<u>\$336,361</u>

BLWC states that \$282,702.96 of these plant improvements were funded by advances from Pines Resorts and to its knowledge, the improvements have been previously placed in ratebase.² BLWC indicates that the remainder, \$53,658.04 of these improvements, was funded by internally generated funds.

The 2004 through 2007 capital improvements appear to be part of the improvements that were addressed in Res. W-4741. Of the total 2004 to 2007 plant additions of \$209,155, \$122,700.90 was funded by advances from Pines Resorts. BLWC indicates that the remainder, \$86,454.10, was funded by internally generated funds.

BLWC's capital improvements from 2002 through 2007, and the proposed payment of funds advanced by Pines Resorts, are among the permitted uses of proceeds under § 817. However, we will not make a finding in this Resolution concerning the reasonableness of BLWC's plant investments nor the reasonableness of the cost of money arising from this loan. These issues are normally addressed in general rate cases or other ratemaking proceedings.

C. Loan B and Use of Proceeds

BLWC requests that the principal amount of Loan B be \$244,067, with a fixed term of 15 years and an annual interest rate of 6.50%. BLWC estimates that the annual principal and interest payment will be \$25,917.24.

In 2008, BLWC states that it undertook the following plant improvements, in Table 5, that it asserts that it funded through advances from Pines Resorts. According to

² DWA notes that annual reports submitted to the Commission are to be a complete and correct statement of business and affairs, and are submitted under penalty of perjury.

BLWC, it will use the proceeds of Loan B to liquidate 85% of the advances it used to fund the following capital improvements, and convert the remainder, \$43,070, or 15%, to paid-in capital.

Table 5
2008 Improvements Funded by Advances per BLWC

<u>Year</u>	<u>Description</u>	<u>Cost</u>	<u>Total</u>
2008	Main Replacement on Acorn	\$ 93,598.85	\$ 93,598.85
	Main Replacement on Road 22	193,539.11	<u>193,539.11</u>
	Total Plant Improvements		<u>\$287,137.96</u>

The capital improvements of \$287,137.96 appear to be part of the 2008 additions totaling \$485,242, addressed in Res. W-4741. The remainder, \$198,104.04, BLWC states was funded by internally-generated funds.

BLWC's capital improvements for 2008, and the proposed payment of funds advanced by Pines Resorts, are among the permitted uses of proceeds under § 817. However, we will not make a finding in this Resolution concerning the reasonableness of BLWC's plant investments nor the reasonableness of the cost of money arising from this loan. These issues are normally addressed in general rate cases or other ratemaking proceedings.

D. Capital Ratios

BLWC's capital ratios as of December 31, 2008, are presented below as recorded and adjusted to give pro forma effect to the transactions listed.

**Table 6
 Capital Structure**

	<u>Recorded</u>		<u>Adjustments</u>	<u>Proforma</u>	
Long-term debt	\$ 148,446	10.27%	\$ 440,214 ^(A)	\$ 588,660	42.13%
Short-term debt	<u>776,937</u>	<u>53.73%</u>	<u>(776,937)^(B)</u>	<u>-</u>	<u>0.00%</u>
Subtotal	\$ 925,383	64.00%	\$(336,723)	\$ 588,660	42.13%
Common Stock	\$ 49,100	3.40%	\$ -	49,100	3.51%
Paid In Capital	1,030,900	71.30%	188,277 ^(C)	1,219,177	87.24%
Retained Earnings	<u>(559,505)</u>	<u>(38.70)%</u>	<u>100,000^(D)</u>	<u>(459,505)</u>	<u>(32.88)%</u>
Subtotal	\$ 520,495	36.00%	\$ 288,277	\$ 808,772	57.87%
Total Capitalization	<u>\$1,445,878</u>	<u>100.00%</u>	<u>\$(48,446)</u>	<u>\$1,397,432</u>	<u>100.00%</u>

(A) Issuance of a total of \$588,660 debt requested in this filing and payment of \$148,446 Safe Drinking Water Bond Act loan.

(B) Of the total \$776,937 money advanced by the parent company, \$588,660 will be paid by the proceeds requested in this filing and \$188,277 will be converted to paid-in capital.

(C) \$188,277 booked to paid in capital.

(D) Projected net earnings of \$100,000 pursuant to recent rate base offset increase authorized by Res. W-4741, dated February 20, 2009.

The table above, shown for illustrative purposes, indicates that the estimated change in the recorded capital structure, given the proposed issuance of debt is material. However, capital structures are normally subject to review in cost of capital or general rate case proceedings. We will not make a finding in this Resolution on the reasonableness of the projected capital ratios for ratemaking purposes.

DISCUSSION

As a public utility, BLWC has the responsibility to maintain its quality of service and provide necessary improvement to its present water system.

However, § 818 states that no public utility may issue notes or other evidences of indebtedness payable at periods of more than 12 months 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.

In addition, § 851 requires Commission authorization before a utility may “lease, assign, mortgage, or otherwise dispose of or encumber the whole or any part of its... plant, system or other property necessary or useful in the performance of its duties to the public...”

The \$500,000 debt facility and any unsecured and undocumented advances, beginning in 2002, which all extended over a 12-month period, were executed without prior Commission approval.

BLWC is in violation of the provisions of Article 5. Stocks and Security transactions of the Pub. Util. Code for its failure to secure Commission authorization prior to incurring the indebtedness stated above. This makes this transaction void under § 825, which states in part:

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 or not conforming in its provisions to any of the provisions which is required by the order of authorization to contain, is void.

The Commission has no power to validate debt which, under the Pub. Util. Code is *void ab initio*. A debt for which the Commission’s authorization is necessary is void unless such authorization has been secured, and the Commission has no power to make valid an act which is void.

However, BLWC’s use of authorized loan proceeds for the construction of improvements or for the refunding of debt are proper uses pursuant to §§ 817(b) and 817(d). Considering that the proceeds of the unauthorized debt appear to have been used for the construction, completion or improvement of BLWC’s facilities, we will require BLWC to execute a replacement Line-of-Credit Agreement with Pines Resorts, using the amount of the outstanding principal

balance of the void debt as the principal amount, and the remaining years and months as the term. Once the new debt instrument is executed, we authorize BLWC to borrow the total amount of \$588,660 from the Bank and to encumber its assets in connection with the loans.

Our authorization is not to be construed as a finding of the value of BLWC's capital projects nor as indicative of the amounts to be included in proceedings for the determination of just and reasonable rates. The interest rate on the debt, the capital expenditures, and the resulting assets are normally addressed in cost of capital or general rate case proceedings.

We will not impose a penalty at this time. BLWC is put on notice by this Resolution that the Commission does not permit a utility, either through carelessness or design, to disobey the provisions of the Public Utility Code and Commission orders, either in letter or in spirit. If in the future the Commission becomes convinced that any of its orders are being knowingly violated, BLWC will find us less accommodating.

We remind BLWC of the provision of § 856:

Every officer, agent or employee of a public utility, or of a subsidiary or affiliate of, or a corporation holding a controlling interest in, a public utility, and every other person subject to the requirements of this article, who violates or fails to comply with, or procures, aids, or abets any violation of, this article is guilty of a misdemeanor.

FEES

Whenever the Commission authorizes a utility to issue debt, the Commission is required to charge and collect a fee in accordance with § 1904(b).

The fee for this financing authority as required by § 1904(b) is \$1,177.³

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.

³ The amount subject to the fee is \$588,660. The fee is determined as follows:
 $(\$2 \times (588,660/1000)) = \$1,177.$

BLWC, the only party in this filing, has informed the DWA that it has no objection to the condition added to the relief requested in the filing, and that it is waiving its right to the 30-day public review and comment period. The added condition requires BLWC to execute and issue a new debt instrument to replace the unauthorized debt transaction with Pines Resorts.

Accordingly, pursuant to § 311(g) (2), the otherwise applicable 30-day period for public review and comment is being waived.

FINDINGS

1. BLWC, a California corporation, is a Class C water utility subject to the jurisdiction of this Commission.
2. Beginning in 2002, and continuing through 2008, BLWC entered into unauthorized advances with its parent company, Pines Resorts.
3. On May 8, 2008, BLWC entered into a \$500,000 Line-of-Credit Agreement with Pines Resorts, without the prior authorization of the Commission.
4. BLWC's current line-of-credit with Pines Resorts is void.
5. From 2002 through 2008, BLWC asserts that Pines Resorts advanced a total of \$776,937 to BLWC, which BLWC states was used for capital improvements.
6. BLWC requests to reimburse its advances from Pines Resorts totaling \$588,660, with the proceeds of the proposed loans in this filing.
7. BLWC plans to convert \$103,880 of the advances from Pines Resorts that were used for capital improvements to paid-in-capital.
8. BLWC is responsible for maintaining its quality of service and providing necessary improvements to its water system.
9. The proposed borrowing in this filing is for proper purposes and is not adverse to the public interest.
10. The reasonableness of the capital expenditures, the value of BLWC's capital projects, and the interest rate arising from debt are normally subject to review in cost of capital or general rate case proceedings.
11. The reasonableness of capital structures are normally subject to review in cost of capital or general rate case proceedings.

12. No protests have been received.
13. BLWC, the only party to this filing, informed the DWA that it has no objection to the condition added to the relief requested in the filing and that it is waiving its right to the 30-day public review and comment period.

CONCLUSIONS OF LAW

1. BLWC's existing line-of-credit with Pines Resorts is void.
2. The execution and issuance of a new debt instrument to replace the unauthorized transaction with Pines Resorts would rectify BLWC's omission and would not be adverse to the public interest.
3. BLWC's proposed debt should be authorized.
4. BLWC should be authorized to execute loan agreements and encumber its property whenever such encumbrance serves to secure the debt authorized herein.
5. The Commission does not by this Resolution determine that the value of BLWC's capital projects, construction expenditures, or cost of debt presented in the filing, are necessary or reasonable for ratemaking purposes.
6. This Resolution makes no determination of the reasonableness of the projected capital ratios for ratemaking purposes.
7. Pursuant to § 1904(b), BLWC should pay a fee of \$1,177.

THEREFORE, IT IS ORDERED THAT:

1. Bass Lake Water Company is authorized to execute a replacement Line-of-Credit Agreement with its parent, Pines Resorts of California, LLC using the amount of the outstanding principal balance of the void debt as the principal amount, and the remaining years and months as the term.
2. Prior to executing a loan agreement with the Plumas Bank, Bass Lake Water Company shall file with the Division of Water and Audits' Utility Audit, Finance and Compliance Branch a copy of the required replacement Line-of-Credit Agreement with Pines Resorts of California, LLC.
3. After Bass Lake Water Company executes a new Line of Credit Agreement with Pines Resorts of California, LLC, and submits a copy of the executed Line

