

**PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA****DIVISION OF WATER AND AUDITS  
Water and Sewer Advisory Branch****RESOLUTION W-4970  
January 16, 2014****RESOLUTION****(RES. W-4970) RESOLUTION GRANTING LUKINS  
BROTHERS WATER COMPANY AUTHORITY TO  
BORROW \$110,000 IN ADDITION TO THE  
\$2,000,000 AUTHORIZED IN RESOLUTION W-4886.**

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**SUMMARY**

This Resolution grants Lukins Brothers Water Company (LBWC) the authority requested in its Advice Letter (AL) 51 filed on September 5, 2013.

LBWC requests authority pursuant to §§ 816 through 851 of the Public Utilities Code, to:<sup>1</sup>

1. Borrow \$110,000 in addition to the \$2,000,000 authorized in Resolution (Res.) W-4886 from Plumas Bank or other financial institutions and encumber utility assets in connection with the loan.
2. Use the loan proceeds to fund interest during construction, increased construction costs and debt issuance costs.
3. Implement a surcharge and a 10% reserve requirement as may be required by the lender for the amortization of a total loan of \$2,110,000.

**BACKGROUND**

LBWC, a California corporation, is a Class C water utility subject to the jurisdiction of the California Public Utilities Commission (Commission). LBWC provides water service to approximately 940 flat-rate connections and 25 metered residential customers.

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<sup>1</sup> All statutory references are to the Public Utilities Code unless otherwise indicated.

By written agreement, LBWC also provides public fire protection water service to 13 fire hydrants. LBWC’s service territory is in the Lukins Subdivision, totally within the City of South Lake Tahoe (City) in El Dorado County. Two other water utilities, the South Tahoe Public Utility District (STPUD) and the Tahoe Keys Homeowners Association serve water to the remainder of the City.

LBWC’s water system includes approximately 400 feet of two-inch water mains, 48,000 feet of four-inch mains, 7,600 feet of 6-inch mains, and 1,300 feet of 8-inch mains. According to LBWC, the mains and wells are almost fully depreciated and some parts of the system cannot carry sufficient water for adequate fire flow because the mains are too small. LBWC asserts that its system does not meet the current fire code standards because, among other things, it does not have sufficient hydrants in its service areas.

In 2007, the Angora fire burned 3,100 acres of land and destroyed 254 homes near LBWC’s service area. Soon thereafter, the City, local fire agencies, customers and LBWC saw the need to improve LBWC’s system so that, among other things, the system could provide adequate fire flow. However, LBWC indicated that it did not have the funds to invest nor were there any grants available for fire protection improvements.

On November 12, 2008, the City filed a complaint with the Commission against LBWC. In its complaint, the City alleged that the inadequacies in LBWC's system created a severe hazard to life, property, and the public safety. The Commission agreed and, in consultation with the parties, issued Res. W-4276, in which we indicated that the rehabilitation of LBWC's system was urgently needed, and authorized LBWC to partially fund improvements via a System Improvement Charge.

In 2009, LBWC’s consultants proposed 11 phases of construction to complete the entire project, including the proposed water system layout and required fire-flows, and the water system pressure distribution. LBWC’s consultants estimated that LBWC would need \$29,797,939 to rehabilitate its water system.

**Table 1  
Estimated Total Project Costs**

Phase 1	\$1,591,240
Phase 2	\$6,117,289
Phase 3 to 11	\$22,089,410
<b>Total</b>	<b>\$29,797,939</b>

According to the consultants, each phase of the project can stand alone. Phase 1 ties the main water supply together and creates a main trunk line through the middle of the water system. Phases 2 to 4 consist of installing 12” main lines for fire protection for approximately 89% of the water system. Phases 1 and 2 are critical and would be the backbone for the entire system.

On July 2, 2009, LBWC entered into a Stipulation Agreement with the City regarding the construction, system improvements, upgrades, and the short-term need to address critical fire hazard areas and conditions. The Stipulation Agreement requires LBWC to use its best efforts to find funding and to proceed with the improvements expeditiously beginning with Phases 1 and 2.

On October 20, 2011, the Commission issued Res. W-4886 authorizing LBWC, among other things, to borrow \$2,000,000 from financial institutions, encumber utility assets, use the loan proceeds to finance the construction of Phase 1 and part of Phase 2, any issuance costs, and if the lender requires a surcharge as a condition of the debt facility, to impose a surcharge on its customers.

Res. W-4886 did not "authorize any capital expenditures or construction projects." We cautioned LBWC to "comply with all environmental permitting requirements applicable to the project that it [would] undertake in conjunction with the proposed loan."

## A. Financial Information

In its Income Statement for the year ending December 31, 2012, LBWC reported that it generated total operating revenues of \$491,541 with a net loss of \$8,543.<sup>2</sup> LBWC's Balance Sheet, reported as of December 31, 2012, is summarized in the following table.<sup>3</sup>

**Table 2**  
**Balance Sheet as of December 31, 2012**

<u>Assets</u>	<u>Amount</u>
Net Utility Plant	\$ 214,976
Investments	0
Current Assets & Accrued Assets	21,495
Deferred Charges	0
<b>Total Assets and Deferred Charges</b>	<b>\$236,471</b>
<u>Liabilities &amp; Equity</u>	<u>Amount</u>
Common Stock	\$ 25,000
Other Paid-in Capital	559,184
Retained Earnings	(655,634)
Long-Term Debt	43,232
Current & Accrued Liabilities	264,689
Deferred Credits	0
<b>Total Liabilities &amp; Equity</b>	<b>\$236,471</b>

On May 8, 2010, Melvin L. Lukins and Sons Inc. forgave a \$597,708 debt owed by LBWC for contract work performed in prior years. The amount of \$597,708 was recorded as a credit to Retained Earnings and the Other Paid-In Capital account was subsequently adjusted.

<sup>2</sup> Based on revised 2012 Annual Report, filed August 5, 2013.

<sup>3</sup> Ibid

LBWC's last general rate increase became effective October 27, 2009, pursuant to Res. W-4791, dated October 15, 2009. The Commission authorized an interim general rate increase of \$126,460, or 36.03%, over the then revenues at present rates of \$350,981. In Res. W-4791, the Commission noted that LBWC's annual reports were inadequate and inaccurate. For this reason, the Utility Audit, Finance and Compliance Branch (UAFCB) of the Division of Water and Audits (Division) requested that the rate increase be interim, so that a surcharge or surcredit could be imposed in the future to adjust revenues to what they should have been based on an in-depth audit of LBWC's records.

On March 1, 2012, UAFCB issued its Financial Audit Report regarding LBWC's financial statements for the years ending December 31, 2010, 2009, and 2008. The report opined that, except for material noncompliance related with certain account balances, the financial statements, in all material respects, fairly presented the financial position of LBWC and the results of its operations.

On April 3, 2012, pursuant to recommendations from UAFCB's audit, LBWC filed a 2010 Revised Annual Report correcting the balance in its Plant in Service and Accumulated Depreciation accounts and reclassified an entry from the Retained Earnings account to Other Paid-in Capital account.

Since its last general rate increase, LBWC received several increases under the Consumer Price Index for All Urban Customers (CPI-U), and in 2013, LBWC received increases to recover higher rental costs and revenue shortfalls.<sup>4</sup> LBWC's AL 50 requesting authority to recover a revenue shortfall (over 3 years amounting to \$31,800) pursuant to Ordering Paragraph 2 of Res. W-4953 was recently approved and became effective on October 1, 2013.

## **B. Financing Request**

By AL 51, LBWC now seeks authorization to (1) borrow \$110,000 from Plumas Bank or other financial institutions in addition to the \$2,000,000 authorized in Res. W-4886; (2) use the proceeds to fund interest during construction, increased construction costs, and debt issuance costs; (3) impose a surcharge; and (4) encumber utility assets.

According to LBWC, the credit market tightened in 2011 and in the first half of 2012. LBWC asserts that investors were not interested in extending a loan to LBWC. However, LBWC indicates that the credit market has changed since the early part of 2012 and there are now several financial institutions that expressed an interest in underwriting a loan. On May 1, 2013, Plumas Bank submitted an Expression of Interest (EOI) to provide financing for Phase 1 of the comprehensive system upgrade described in Res. W-4886. One of the conditions required by Plumas Bank is an increase in the total loan amount in order to fund interest expense during construction.

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<sup>4</sup> See AL 44, 49 and 50 and Res. W-4953.

On August 26, 2013, LBWC entered into a Construction Loan Agreement with Plumas Bank for a loan of \$2,000,000 pursuant to Res. W-4886. According to LBWC, upon completion of Phase 1, any funds remaining will be applied to selected projects outlined in Phase 2.

LBWC states in AL 51 that Plumas Bank requires the utility to increase the total loan amount to bridge the loan's construction period interest payments and because the project costs are now higher than the cost projections in 2011 when the \$2,000,000 financing authority was sought.

Plumas Bank's EOI states the basic terms under which a construction/ permanent loan of up to \$2,110,000 will be provided to LBWC. The loan will be fully amortized with monthly principal and interest payments due every month for 20 years. The interest rate is estimated to be 6.5% and will be determined by market conditions as of the actual closing date of the loan. The \$110,000 loan increase will be used to pay interest during the construction period and any remainder would be for increase in construction costs and loan fees. The first regular monthly amortization payment is expected in March 2014. The long-term debt will be secured by LBWC's assets. The construction is estimated to be six to twelve months, weather permitting, and upon completion of the project, the construction loan will convert into a permanent loan.

In its EOI, Plumas Bank indicated that the rates and terms of the loan will vary depending upon a complete risk analysis, collateral quality and other factors. Among others, the Bank set the following conditions for the loan extended to LBWC:

1. The percentage of completion disbursement of loan proceeds will be based on Plumas Bank's independent engineer site inspections.
2. A construction account and a surcharge account will be kept at Plumas Bank.
3. Plumas Bank, as a fiscal services agent under a Fiscal Services Agreement, will be tracking the surcharge account.
4. All assets of the water company shall be encumbered.

LBWC's proposed monthly surcharge for the original \$2,000,000 debt authorized in Res. W-4886 is shown in the following table.<sup>5</sup>

**Table 3**  
**Proposed Monthly Surcharge**  
**\$2,000,000 Loan**

<u>Service</u>	<u>1-10 Years</u>	<u>11-19 Years</u> <sup>6</sup>
5/ 8 x 3/4-inch meter	\$ 8.68	\$ 7.89
3/4-inch meter	13.01	11.83
1-inch meter	21.69	19.72
1 1/2-inch meter	43.38	39.44
2-inch meter	69.41	63.10
3-inch meter	130.14	118.31
4-inch meter	216.90	197.19

According to Res. W-4886, the monthly bill for a commercial 1-inch metered customer using an average of approximately 600 cubic feet of water per month, at a quantity rate of \$1.475 per 100 cubic feet, and a service charge of \$32.51 would have increased by \$21.69, or 52.4%, from \$41.63 to \$63.05 for the first 10 years of the loan and by \$19.72, or 47.7%, from \$41.36 to \$61.08 thereafter. The monthly bill for a typical single-family residential flat-rate customer with a 3/4-inch service connection would have increased by \$13.01, or 39.5%, from \$32.96 to \$45.97 for the first 10 years of the loan and by \$11.83, or 35.9%, from \$32.96 to \$44.79 for the remainder of the life of the loan.

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<sup>5</sup> To date, the surcharge rates have not been implemented. Res. W-4886 requires LBWC to file a Tier 2 advice letter to implement the surcharge rates, three months prior to the first monthly loan payment.

<sup>6</sup> With a 10% reserve requirement, the loan would be paid back within 19 years.

With the requested loan addition of \$110,000, LBWC re-calculated the monthly surcharge rates for a total loan of \$2,110,000, as shown in the following table.

**Table 4**  
**Proposed Monthly Surcharge**  
**\$2,110,000 Loan**

<u>Service</u>	<u>1-10 Years</u>	<u>11-19 Years</u> <sup>7</sup>
5/ 8 x ¾-inch meter	\$ 8.68	\$ 8.05
¾-inch meter	13.29	12.08
1-inch meter	22.15	20.13
1 ½-inch meter	44.29	40.27
2-inch meter	70.87	64.43
3-inch meter	132.88	120.80
4-inch meter	221.47	201.33
6-inch meter	442.93	402.66
8-inch meter	708.69	644.26

The current monthly bill for a commercial 1-inch metered customer using an average of approximately 600 cubic feet of water per month, at a quantity rate of \$1.61 per 100 cubic feet and a monthly service charge of \$35.40 (\$424.81 annually) is currently \$45.06.<sup>8</sup>

The re-calculated surcharge for a commercial 1-inch metered customer would increase over the previously proposed surcharge by \$0.46, or 2.1%, from \$21.69 to \$22.15 for the first 10 years and by \$0.41, or 2.1%, from \$19.72 to \$20.13 thereafter. With the re-calculated surcharge rates, the monthly bill for the first 10 years of the loan term would increase by \$22.15, or 49.2%, from \$45.06 to \$67.21. Thereafter, the increase would be \$20.13, or 44.7%, from \$45.06 to \$65.19.

The current monthly bill for a typical single-family residential flat-rate customer with a ¾-inch service connection is currently \$35.87 (\$430.53 annually).<sup>9</sup>

The re-calculated surcharge for a single-family residential flat-rate customer with a ¾-inch service connection would increase over the previously proposed surcharge by \$0.28, or 2.2%, from \$13.01 to \$13.29 for the first 10 years and by \$0.25, or 2.1%, from \$11.83 to \$12.08 thereafter. With the re-calculated surcharge rates, the monthly bill for the first 10 years of the loan term would increase by \$13.29, or 37.1%, from \$35.87 to \$49.16. Thereafter, the increase would be \$12.08, or 33.7%, from \$35.87 to \$47.95.

<sup>7</sup> With a 10% reserve requirement, the loan would be paid back within 19 years.

<sup>8</sup> In 2011, the quantity rate per 100 cubic feet was \$1.475 and the service charge for a 1-inch metered customer was \$32.51 per month.

<sup>9</sup> In 2011, the residential flat-rate service charge for a ¾-inch service connection was \$32.96 per month.

### C. Construction Budget

The projected construction budget for Phase 1 and part of Phase 2 plus contingency and loan costs, as shown in Res. W-4886, is replicated in the following table.

**Table 5**  
**2011 Construction Budget**

Mains, Pipes, and Fire Hydrants (Phase 1 and part of Phase 2)	\$1,502,000
Mobilization, Traffic Control and Erosion Control (Phase 1)	143,000
<b>Total Estimated Construction Costs</b>	<b>\$1,645,000</b>
Contingency (Phase 1)	255,000
Loan Closing Costs	100,000
<b>Total</b>	<b>2,000,000</b>

LBWC indicated in AL 51 that it solicited an invitation to bid for the project from three companies. According to LBWC, Haen Engineering was the only responsive bid and the project costs submitted by Haen Engineering are materially higher than the cost projections in 2011 when the \$2,000,000 financing authority was requested.

The construction costs for Phase 1 per Haen Engineering include testing, permitting, appraisal, contingency, interest payment during construction and loan closing costs, and they are shown in the following table.

**Table 6**  
**Updated 2013 Construction Budget**

Mains, Pipes, and Fire Hydrants (Phase 1)	\$1,547,000
Mobilization, Traffic Control and Erosion Control (Phase 1)	223,000
<b>Total Estimated Construction Costs</b>	<b>\$1,770,000</b>
Compaction Testing	5,000
Permitting	29,475
Appraisal	43,000
Contingency (Phase 1)	9,825
Bank Loan Fee	42,200
Interest Payment During Construction	110,000
Loan Closing Costs	100,000
<b>Total</b>	<b>2,110,000</b>

Haen Engineering's bid indicates an increase in the overall project costs. The estimate for mains, pipes, and fire hydrants for Phase 1 increased by \$45,000 from the estimated \$1,502,000 in Res. W-4886 to \$1,547,000. The mobilization, traffic control and erosion control for Phase 1 increased by \$80,000 from the estimated \$143,000 in Res. W-4886 to \$223,000. As a result, the total estimated construction costs for Phase 1 is higher by a total of \$125,000. In addition, interest during construction is now required and may cost up to \$110,000. Because of these additional costs and because Haen Engineering bid is a firm bid, LBWC revised its contingency allocation from the estimated \$224,000 in 2011 to \$9,825.<sup>10</sup>

#### D. Cash Requirements Forecast

LBWC's estimated cash requirements forecast, as shown in Exhibit F of its filing, is shown in the following table.

**Table 7**  
**Cash Requirements Forecast**

Funds for Construction	\$2,110,000
Bonds, Notes Retirement	0
Short-Term Debt Repayment	0
<b>Total Cash Requirements</b>	<b>\$2,110,000</b>
Less: Estimated Cash Provided from Internal Sources	0
<b>Funds Required from External Sources</b>	<b>\$2,110,000</b>

LBWC incurred a net loss of \$8,543 in 2012 and asserts that it does not have the means at this time to finance any of its Phase 1 and part of Phase 2 project costs.

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<sup>10</sup> Haen Engineering is contractually obligated to work within the budget. However, any deficiency that may occur could result in a scaling down of Phase 1. As indicated earlier, LBWC claims that upon completion of Phase 1, any remaining funds will be allocated to selected projects in Phase 2.

## E. Capital Structure

In Exhibit G of AL 51, which was revised September 30, 2013, LBWC presented its capital structure, recorded as of December 31, 2012, and adjusted to give pro forma effect to LBWC's proposed debt transaction. LBWC's pro forma capital structure is shown in the following table.

**Table 8**  
**Pro Forma Capital Structure**

	<u>2012 Recorded</u>		<u>Adjustments</u>	<u>2014 Pro Forma</u>	
Long-Term Debt	\$ 43,232	(153.21)%	\$2,110,000 <sup>(A)</sup>	\$2,153,232	99.16%
Common Stock	25,000	(88.59)%	0	25,000	1.15%
Other Paid-In Capital	559,184	(1,981.66)%	0	559,184	25.75%
Retained Earnings	(655,634)	2,323.46%	89.737 <sup>(B)</sup>	(565,897)	(26.06)%
<b>Total Capitalization</b>	<b>(\$28,218)</b>	<b>100.00%</b>	<b>\$2,199,737</b>	<b>\$2,171,519</b>	<b>100.0%</b>

- (A) Issuance of \$2,000,000 authorized in Res. W-4886 plus the \$110,000 requested in this filing.  
(B) Projected net income of \$40,062 in 2013 and \$49,675 in 2014.

As shown in the previous table, LBWC will have almost no equity, resulting in an incongruent debt to equity ratio. This is due primarily to the \$597,798 debt that was reclassified to retained earnings in 2010 and the issuance of the \$2,110,000 new debt.

## NOTICE AND PROTESTS

Pursuant to General Order (G.O.) 96-B, Water Industry Rule 4.1, on September 3, 2013, LBWC served its AL 51 to the interested parties. Notice of AL 51 was made by publication in the Commission's Daily Calendar on September 11, 2013. No protests have been received.

In the Tahoe Daily Tribune, LBWC published a public notice commencing on October 23, 2013 and ending on October 25, 2013, describing the proposed additional loan, the proposed surcharge, and the estimated rate change expressed in both dollar and percentage terms. The Tahoe Daily Tribune is a local newspaper circulated in South Lake Tahoe, California. On October 25, 2013, LBWC notified its flat rate customers by mail of the proposed additional loan and surcharge needed to repay the loan. LBWC notified metered customers by mail on October 31, 2013.

On November 2, 2013, a flat-rate customer, who recently received a new meter as part of LBWC's meter conversion program, expressed concern regarding conversion from flat-rate to metered service and asserts that LBWC is unfairly imposing metered rates to a handful of its customer base of 963 customers, beginning January 2014.<sup>11</sup> The customer requests that the metered rates be implemented, at a minimum, on January 1,

<sup>11</sup> According to the letter, as of October 2013, water meters were installed by LBWC at approximately 30 households.

2015 or not until 100% of the customers have water meters installed. As of December 31, 2012, LBWC reported 25 metered customers in its 2012 annual report.

On November 22, 2013, LBWC responded to the customer's concern indicating that it has existing metered customers and the current annual metered rates and conditions are included in LBWC's tariffs authorized by the Public Utilities Commission. LBWC asserts that not charging metered rates to customers with new meters would be unjust and discriminatory to the already existing metered customers. In its letter, LBWC offered to provide new meter customers with free estimated monthly reading from October 2013 through December 2013, and in order to promote water conservation, would bill customers monthly to help customers determine its consumption.

## **DISCUSSION**

As a public utility, LBWC has the responsibility to maintain its quality of service, provide adequate water flow for fire protection, and provide necessary improvements to its water system. LBWC's mains and wells are almost fully depreciated and are near the end of their normal service life. Parts of the water system cannot carry enough water for adequate fire flow because the mains are too small. In addition, there are only a few hydrants in the service area to meet current fire code standards. These deficiencies and the need to improve LBWC's water system were discussed in Res. W-4726 and Res. W-4886.

LBWC was only recently able to negotiate and finalize a \$2,000,000 loan from Plumas Bank to finance Phase 1 of the comprehensive system upgrade described in Res. W-4886. As part of Plumas Bank's loan requirements, LBWC is required to pay interest on the loan during the construction period. However, pursuant to Res. W-4886, the surcharge cannot be imposed until three months before the first loan payment that is estimated to start in March 2014.

As shown in its Cash Flow Statement, LBWC will need the \$110,000 in additional costs to be funded through additional borrowing. LBWC incurred a net loss in 2012 and it asserts that it does not have the means to fund the interest payments during construction and the increased construction costs of Phase 1.

LBWC indicated that it will be capitalizing the interest during construction and the Phase 1 project costs that will be funded with the loan addition. Section 817 provides that a public utility may issue stocks and bonds, notes, and other evidences of indebtedness payable at periods of more than 12 months after the date thereof, for certain purposes, including the construction, completion, extension, or improvement of its facilities and the improvement or maintenance of its service. The cost of debt issuance and capitalized construction costs fall within the scope of § 817 and would be a proper use of funds under § 817.

Since the loan for the project will be funded by a surcharge, the associated plant funded by the loan cannot be booked into ratebase. Although the plant will not be part of ratebase, it still is required to be reasonable. Such reasonableness is subject to review in a general rate case or other proceedings. The Commission will not make a finding in this Resolution on the reasonableness of the project costs.

The requested \$110,000 additional loan, the subject of this filing, appears necessary to help LBWC meet its projected funds requirements. However, we will not address the cost of money resulting from LBWC's issuance of debt. Such reasonableness is subject to review in a cost of capital assessment or other proceedings.

The construction of the planned improvements and the issuance of the proposed debt will increase LBWC's assets and change its capitalization. LBWC will have an unbalanced capital structure after the financing that is not typical or appropriate for ratemaking. Recorded capital structures may or may not be used for the ratemaking capital structure. Capital structures are normally subject to review in general rate cases or other proceedings. The Commission will not make a finding in this Resolution on the reasonableness of the projected capital ratios for ratemaking purposes.

Section 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. Section 818 requires the Commission, in issuing such an order, to find that the money, property, or labor to be procured or paid for with the proceeds of the debt authorized is reasonably required for the purposes specified in the order and, unless expressly permitted in an order authorizing debt, that those purposes are not, in whole or in part, reasonably chargeable to expenses or to income.

Due to the current state of the economy, there are limited funds available through state or federal grants for small water companies. Banks and commercial lenders are now very selective in lending and have strict credit guidelines and rigid conditions in their loan and funding agreements. To the extent that the interest during construction requirement remains a condition of the lender to provide the funding, we need to consider LBWC's request for an additional \$110,000 cost to be added to the authorization in Res. W-4886.

The ratepayers ultimately pay for all water system requirements and improvements, regardless of the manner in which they are financed. The surcharge method of recovery ensures that the loan will be repaid without financial stress to the water utility. The surcharge serves only to repay the loan and will not generate any profit for the utility owners.

LBWC needs to make necessary improvements to its system. The estimated costs to complete the system have increased and the available lender is requiring interest during construction, which also increases the overall costs of the project. Both the project costs and the capitalized interest are not reasonably chargeable to expenses or to income.

LBWC's proposed borrowing and the money, property, or labor to be procured or paid for with the proceeds of the debt authorized by this Resolution are reasonably required for the purposes specified in this Resolution, and the improvements to be funded by the debt will benefit ratepayers over many years. Consequently, it is in the public interest to authorize LBWC to secure an additional \$110,000 to be used for interest payments during construction and the increase in construction costs, and to increase the surcharge to recover the increased costs.

The Commission has, in the past, authorized a service fee for new service to undeveloped lots.<sup>12</sup> In Res. W-4886, LBWC was authorized in connection with the \$2,000,000 loan and implementation of the surcharge, to collect a service fee for future customers who will benefit from the expenditures being made from the proceeds of the \$2,000,000 loan. The amount of the service fee would be the accumulated total of the surcharge from its inception to the time of service connection, subject to a maximum of \$2,000. The monthly surcharge would apply thereafter. Such service fees serve to recover some of the system improvements costs from future customers who will benefit from the system improvements.

It is appropriate to emphasize that the surcharge and service fee will cover only the cost of the loan incurred to finance LBWC's improvement and addition to plant. It will not preclude any future rate increase request to cover rising costs of repair, materials, wages, property taxes, power bills, or other operating expenses that may be incurred in connection with operating the new facilities.

Section 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..." Section 851 permits the encumbrance of utility assets when such encumbrance serves to secure authorized debt and the Commission frequently authorizes such encumbrance where, as here, it is not adverse to the public interest. The cost of the project financed through the surcharge shall be excluded from ratebase for ratemaking purposes.

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<sup>12</sup> The Commission has authorized utilities to impose a service fee for new service when such authority is coupled with approval of surcharge rates. In Res. W-4234 dated December 7, 2000, Sereno Del Mar Water Co. was authorized, in connection with a \$250,000 loan under the Safe Drinking Water State Revolving Fund to impose a surcharge to existing customers and a service fee for future customers. In Res. W-4307 dated October 25, 2001, Sequoia Crest, Inc., in conjunction with a \$159,108 loan was authorized to impose a surcharge to repay the loan and a maximum service fee of \$2,000 to customers requesting future services to undeveloped lots.

As set forth herein, we will authorize LBWC to (1) obtain a loan addition of \$110,000 to fund interest during construction, the estimated increase in costs of Phase 1, and any issuance costs; (2) encumber its assets in connection with the loan; (3) impose a surcharge on its customers; and (4) impose a service fee for new service to currently vacant and undeveloped lots. Our approval does not authorize any capital expenditures or specific construction projects, but rather the creation of a funding mechanism to finance improvements to the existing utility system. Our approval does not authorize nor address any other debt service coverage or revenue requirement that the lender may require LBWC, except for the surcharge rates with a 10% reserve for the first ten years and the surcharge rates without the 10% reserve from the eleventh year until the loan is fully paid. All other rate requirements are outside the scope of this Resolution.

The key factors that were considered in the Commission's disposition of LBWC's request for the \$110,000 debt authority in this filing include:

1. LBWC's intention to provide adequate fire flow and sufficient hydrants, and replace deteriorated mains.
2. The need for the improvement of LBWC's system was recognized by the City, local fire agencies, customers, and the Commission.
3. The interest during construction requirement imposed on LBWC by Plumas Bank in conjunction with the loan is appropriate.
4. Interest payment during construction is an integral part of the cost of the loan.
5. LBWC is required to open a construction account at Plumas Bank and a surcharge account required for customer surcharge payments tracking.
6. Plumas Bank will be the fiscal services agent.
7. The conditions imposed by the Commission for the proper treatment of the surcharge and plant financed with the loan pursuant to Ordering Paragraph No. 2 of Res. W-4886 remains in full force and effect.

In connection with the project to be funded by the authority granted in this Resolution, we are informing LBWC that the Commission encourages all investor-owned utilities to actively participate in the Commission's supplier diversity program as set forth in G.O. 156, whether mandated or otherwise, and provide financial opportunities to Women/ Minority/ Disabled Veteran Business Enterprises, as this is vital to the economic recovery and stability of our communities and our State.

## **COMPETITIVE BIDDING RULE**

Under the provisions of Res. F-616, LBWC's proposed issuance of debt is exempt from the Commission's Competitive Bidding Rule because the principal amount does not exceed \$20,000,000.

## **REPORTING REQUIREMENT**

G.O. 24-B requires utilities to submit a monthly report to the Commission that contains, among other things, (1) the amount of debt and equity securities issued by the utility during the prior month; (2) the total amount of debt and equity securities outstanding at the end of the prior month; (3) the purposes for which the utility expended the proceeds realized from the issuance of debt and equity securities during the prior month; and (4) a monthly statement of the separate bank account that the utility is required to maintain for all receipts and disbursement of money obtained from the issuance of debt and equity securities. On or before the 25<sup>th</sup> day of each month, LBWC should file, with UAFCB, the reports required by G.O. 24-B.

## **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 \$220.<sup>13</sup> LBWC must issue the check payable to the California Public Utilities Commission and remit the payment to the Commission's Fiscal Office.

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<sup>13</sup> The fee is assessed on \$110,000 of authorized borrowing as follows: \$2 times (\$110,000/ \$1,000) equals \$220.

## **COMMENTS**

While one customer expressed concern regarding LBWC's meter conversion program, the customer did not indicate any concern regarding the loan increase and there was no showing as to why the proposed project would not lead to the improvement of service or why the proposed surcharge would not be justified. The customer's concern to pay metered rates by January 1, 2015 is not germane to LBWC's AL 51 or to the authority being granted in this Resolution. The surcharge rates to pay for the loan will be implemented three months prior to the first monthly loan payment, subject to review and approval, and periodically thereafter, to account for customer growth and status of LBWC's balancing account.

Public Utilities Code 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 is being mailed to all parties and made available for public comment on December 13, 2013.

On December 31, 2013, as amended on January 1, 2014, the same customer that commented on AL 51 submitted comments on the draft resolution. The customer reiterated its concerns that was expressed on AL 51, in that it objects to all costs associated with the installation of water meters, including the monthly surcharge and added that it does not understand how the financing impacts them or how the surcharge is calculated. As explained in the proposed resolution, the customer did not make a showing as to why the proposed project would not lead to the improvement of service or why the proposed surcharge would not be justified. The surcharge rates are clearly defined herein, showing the monthly financial impact and the surcharge does not provide for the installation of water meters.

## **FINDINGS**

1. LBWC, a California corporation, is a Class C water utility subject to the jurisdiction of the Commission.
2. LBWC is responsible for maintaining its quality of service and providing necessary improvements to its water system.
3. LBWC does not meet current fire code standards because it does not have sufficient hydrants nor adequate fire flow in its service area.
4. LBWC indicates that its project will, among other things, upgrade its system to meet the fire code standards.

5. The proposed Phase 1 of LBWC's construction project ties the main water supplies together and creates a main trunk line through the middle of the water system. Phases 1 to 4 consist of installing 12" main lines for fire protection.
6. In Res. W-4886, the Commission authorized LBWC to borrow \$2,000,000 from financial institutions; encumber utility assets to secure the loan; use the loan proceeds to finance the construction of Phase 1 and Part of Phase 2 of its construction project and any issuance costs; and if the lender requires a surcharge as a condition of the debt facility, impose a surcharge on its customers. The Commission further instructed LBWC to "comply with all environmental permitting requirements applicable to the project that it [would] undertake in conjunction with the proposed loan.
7. Undeveloped lots will benefit from the expenditures being made from the proceeds of the debt. The benefits include potentially increased property values and availability of water furnished by a public utility, which meets health standards.
8. Haen Engineering was the only firm that responded to LBWC's bid invitation for constructing Phase 1 and part of Phase 2. The estimates submitted by Haen Engineering are higher than the cost projections in 2011 when the \$2,000,000 debt authority was requested.
9. On August 26, 2013, LBWC entered into a Construction Loan Agreement with Plumas Bank for a loan of \$2,000,000 pursuant to Res. W-4886.
10. To-date, the surcharge rates authorized in Res. W-4886 for the \$2,000,000 loan have not been implemented.
11. Plumas Bank requires LBWC to pay interest on the amount drawn out during the construction period.
12. On September 5, 2013, LBWC filed AL 51 requesting authority to borrow an additional \$110,000 for interest during construction and increased construction costs.
13. Plumas Bank is willing to provide a \$110,000 loan addition to LBWC to be used to fund the interest during construction.
14. In Res. W-4886, the Commission listed eleven conditions that LBWC shall observe if the lender requires a surcharge in connection with the debt facility.
15. On October 23, 2013 and ending October 25, 2013, LBWC published a public notice in the Tahoe Daily Tribune describing the loan increase, the proposed

surcharge, and the estimated rate change expressed in both dollar and percentage terms.

16. On October 25, 2013, LBWC notified its flat-rate customers by mail of the loan increase and surcharge.
17. On October 31, 2013, LBWC notified its metered customers by mail of the loan increase and surcharge.
18. LBWC received a letter from one customer expressing concerns regarding conversion from flat-rate to metered service and requested that the meter rates be implemented on January 1, 2015 or not until 100% of the customers have water meters installed.
19. LBWC acknowledged receipt of the customer's concern and responded to the customer on November 22, 2013. LBWC explained that the metering is part of its meter conversion program and LBWC have existing metered customers.
20. Notice of the filing appeared on the Commission's Daily Calendar on September 11, 2013. No protest have been received except for the one discussed herein.
21. The fee for this financing authority as required by § 1904(b) is \$220.

## **CONCLUSIONS OF LAW**

1. LBWC's proposed \$110,000 loan addition is necessary because Plumas Bank requires interest during construction payments until a surcharge is in place and collection is started for the term loan's principal and interest payments.
2. Capitalized interest during construction, construction costs and loan fees are proper purposes under § 817.
3. As required by Plumas Bank, it is reasonable to authorize LBWC to charge customers the appropriate surcharge rates to recover the loan payments for the \$2,110,000 total loan and any bank and fiscal agent fees.
4. It is reasonable to establish a service fee for new connections pertaining to vacant or undeveloped lots since these lots will benefit from LBWC's system improvements.
5. A service connection fee of up to \$2,000 payable upon connection by customers requesting future services to undeveloped lots is reasonable.

6. It is not adverse to the public interest to allow LBWC to encumber its assets to secure the proposed loan.
7. LBWC should be authorized to execute loan agreements and encumber its property to secure the debt authorized herein so long as the debt is to be used solely for the purposes specified in Table 6 of this Resolution.
8. The cost of the plant financed by the loan authorized herein must not be included in ratebase.
9. Three months prior to the first monthly loan amortization payment, LBWC should file, in accordance with G.O. 96-B, a Tier 2 advice letter to establish the monthly surcharge on customer bills, as shown on Table 4 of this Resolution. Such filing should also include a special condition pertaining to the service fee chargeable to customers requesting future services to undeveloped lots.
10. LBWC's proposed loan is exempt from the Commission's Competitive Bidding Rule.
11. It is LBWC's responsibility to abide by and comply with any applicable environmental regulations for any capital improvement undertaken using the debt authorized herein.
12. Consistent with § 824, LBWC should maintain records to (1) identify the specific long-term debt issued pursuant to this Resolution, and (2) demonstrate that the proceeds from such debt have been used only for the purposes authorized herein.
13. LBWC should provide the Commission with the monthly reports required by G.O. 24-B.

**THEREFORE, IT IS ORDERED THAT:**

1. Lukins Brothers Water Company, Inc. is authorized to borrow an additional \$110,000 from Plumas Bank or other financial institutions; encumber utility assets to secure the loan; use the loan proceeds to finance interest during construction, the construction of Phases 1 and 2 and any issuance costs; and to increase the surcharge authorized in Resolution W-4886 that it will impose on its customers, as set forth herein.
2. The conditions imposed by the Commission for the proper treatment of the surcharge and plant financed with the loan pursuant to Ordering Paragraph No. 2 of Resolution W-4886 remains in full force and effect and shall apply in this Resolution.
3. Lukins Brothers Water Company, Inc. shall file with the Utility Audit, Finance and Compliance Branch of the Division of Water and Audits copies of the loan agreement, fiscal services agreement, bank statement, proof of payment and loan related documents within 15 days of execution.
4. Lukins Brothers Water Company, Inc. shall not use the proceeds authorized by this Resolution to begin the construction of capital projects until Lukins Brothers Water Company, Inc. has obtained any required environmental review under the California Environmental Quality Act.
5. Lukins Brothers Water Company, Inc. is exempt from the Commission's Competitive Bidding Rule for the debt authorized herein.
6. As required in Resolution W-4886, Lukins Brothers Water Company, Inc. shall maintain records to (1) identify the specific long-term debt issued pursuant to this Resolution, and (2) demonstrate that the proceeds from such debt have been used only for the purposes authorized by this Resolution.
7. As required in Resolution W-4886, on or before the 25<sup>th</sup> day of each month, Lukins Brothers Water Company, Inc. shall file with the Utility Audit, Finance and Compliance Branch of the Division of Water and Audits the reports required by General Order 24-B. When the full amount of the debt has been received and reported, and the system improvements completed and all the capital expenditures reported, the General Order 24-B reporting shall terminate and will no longer be required.

8. The authority granted by this Resolution shall become effective when Lukins Brothers Water Company, Inc. pays \$220 as required by Public Utilities Code 1904(b). Lukins Brothers Water Company, Inc. must issue the check payable to the California Public Utilities Commission and remit the payment to the Commission's Fiscal Office.

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 January 16, 2014; the following Commissioners voting favorably thereon:

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PAUL CLANON  
Executive Director

MICHAEL R. PEEVEY  
President

MICHEL PETER FLORIO  
CATHERINE J.K. SANDOVAL

MARK J. FERRON  
CARLA J. PETERMAN  
Commissioners

## **CERTIFICATE OF SERVICE**

**I certify that I have by either electronic mail or postal mail, this day, served a true copy of Final Resolution No. W-4970 on all parties in these filings or their attorneys as shown on the attached lists.**

**Dated January 30, 2014, at San Francisco, California.**

/ s/ DANIEL SONG

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Daniel Song

**Parties should notify the Division of Water and Audits, Fourth Floor, California Public Utilities Commission, 505 Van Ness Avenue, San Francisco, CA 94102, of any change of address to ensure that they continue to receive documents. You must indicate the Resolution number on which your name appears.**

# **LUKINS BROTHERS WATER COMPANY**

## **ADVICE LETTER NO. 51**

### **SERVICE LIST**

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San Mateo, CA 94401

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Lukins Brothers Water Company, Inc.  
2031 West Way  
South Lake Tahoe, CA 96150

Rudy and Robyn Uibel  
2109 12<sup>th</sup> Street  
South Lake Tahoe, CA 96150