

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF COLORADO

PROCEEDING NO. 14A-0698W

IN THE MATTER OF THE APPLICATION OF PROSPECT MOUNTAIN WATER COMPANY, INC. AND NORTH WELD COUNTY WATER DISTRICT FOR APPROVAL OF TRANSFER OF ASSETS.

**DECISION DIRECTING STAFF OF THE
COLORADO PUBLIC UTILITIES COMMISSION
TO MAKE A SHOW CAUSE FILING**

Mailed Date: December 17, 2014
Adopted Date: December 10, 2014

I. BY THE COMMISSION

A. Statement

1. As directed by Decision No. C14-0852 issued July 18, 2014, Staff of the Colorado Public Utilities Commission (Staff) filed a written report of the status of promissory notes issued by Prospect Mountain Water Utility (Prospect Mountain or the Utility).

2. We now direct Staff to propose an order to show cause to the Commission, pursuant to Rule 1302(h) of the Rules of Practice and Procedure, 4 *Code of Colorado of Regulations* 723-1, directing Prospect Mountain to show cause why the notes are not void due to the Utility's violation of statutes, rules, and decisions.

B. Background

3. As part of a 2013 rate case,¹ Prospect Mountain sought Commission approval to sell its Colorado-Big Thompson (C-BT) water rights in order to repay "shareholder debts."²

¹ Proceeding No. 13A-0291W, filed April 2, 2013.

² See Recommended Decision No. R13-1226, ¶ 136 in Proceeding No. 13A-0291W; see also Decision No. C13-1495, ¶¶ 2-4 in the same proceeding.

These debts consisted of two loans from the President of the Board of Directors, Mr. John Heron, to Prospect Mountain.³ The promissory notes, at that time totaling \$260,000, were signed on behalf of Prospect Mountain by Mr. Heron as President, payable to Mr. Heron individually. The C-BT water rights served as collateral for the promissory notes.⁴ Interveners—ratepayers and Staff—questioned the validity of the shareholder debts and objected to Prospect Mountain using any proceeds from the sale of the C-BT water rights to secure the payment of the notes.⁵

4. In May and July 2013, while the rate case was pending, Prospect Mountain issued two additional promissory notes to Mr. Heron for \$100,000 and \$50,000 respectively. Both notes used the C-BT water rights as collateral.⁶

5. Through pre-filed testimony and during a hearing before an Administrative Law Judge (ALJ), Prospect Mountain attempted to prove the validity of the loans to Mr. Heron. None of the Utility's board members submitted testimony; only the accountant, Mr. Robert Lawrence, provided testimony about the shareholder debts.

6. The ALJ found that Mr. Lawrence presented no evidence of loans made from a shareholder to Prospect Mountain or how the Utility spent the loan money.⁷ The ALJ concluded that "[t]he overwhelming evidence in the proceeding is that there was no oversight to the loans and no way to know what the loan money was spent on."⁸

7. ALJ Garvey therefore determined that Prospect Mountain could not use proceeds from the sale of the water rights to repay the alleged shareholder debts, because

³ Recommended Decision No. R13-1226, ¶ 136 n. 75; *see also* Decision No. C13-1495, ¶ 4.

⁴ Recommended Decision No. R13-1226, ¶ 139; *see also* Decision No. C13-1495, ¶ 4.

⁵ Recommended Decision No. R13-1226, ¶ 138.

⁶ Attachment 2 to Staff Audit, 8, 10

⁷ Recommended Decision No. R13-1226, ¶ 142-48.

⁸ *Id.*, ¶ 142.

Prospect Mountain failed to prove that the loans were made in the public interest.⁹ He further ordered Staff to pursue a separate proceeding to determine if there were any valid encumbrances on the water rights before the Commission approves a sale.¹⁰

8. In November 2013, the Commission determined that the purported encumbrances on the C-BT water rights were illegal because the loans were made outside the normal course of utility business without Commission approval, *see* § 40-5-105(1), C.R.S., and that the loans violated a Commission order prohibiting Mr. Heron from assigning any of the Utility's assets without Commission approval.¹¹ The Commission voided the encumbrances and ordered Prospect Mountain to file an application for the sale of the water rights.¹² The Commission also stated that it would: (1) examine possible irregularities related to the shareholder loans, the promissory notes, and Mr. Heron's actions; and (2) address whether voiding the promissory notes themselves is an appropriate remedy.¹³

9. On June 25, 2014, Prospect Mountain filed an application for the transfer of water rights (Proceeding No. 14A-0698W).

10. In July 2014, the Commission granted Prospect Mountain's application to sell the C-BT water rights for \$1,000,000.¹⁴ It also directed Staff to audit the status of the promissory notes in order to help the Commission determine their status, validity, and enforceability.¹⁵

11. In response to Staff's questions, Prospect Mountain produced bank deposit slips, promissory notes, and board meeting minutes, including 5 promissory notes issued to Mr. Heron

⁹ *Id.*; *see also* Decision No. C13-1495, ¶ 6.

¹⁰ Recommended Decision No. R13-1226, Ordering ¶ 8; *see also* Decision No. C13-1495, ¶ 6.

¹¹ Decision No. C13-1495, ¶10 (referencing Decision No. C12-0808 in Proceeding No. 12M-804W issued July 13, 2012).

¹² *Id.*, ¶¶ 10-11.

¹³ *Id.*, ¶ 11.

¹⁴ Decision No. C14-0852 in Proceeding No. 14A-0698W.

¹⁵ *Id.*, ¶ 20.

between 2012 and 2014, and 14 deposits made between 2008 and 2013.¹⁶ The Utility provided no proof of the source of the deposits.

12. The fifth promissory note, issued May 1, 2014, canceled the four previous notes issued in 2012 and 2013, and consolidated the principal amounts, plus interest, into one note.¹⁷ Staff could not reconcile the amount of the fifth promissory note with the evidence provided by Prospect Mountain.

13. Prospect Mountain also provided evidence of promissory notes issued to three other shareholders between 1973 and 1981.¹⁸ Prospect Mountain stated that the principal of these notes is \$32,118 and the interest accrued as of May 1, 2014 is \$100,772.45.¹⁹ Prospect Mountain did not provide a copy of the promissory notes or evidence of deposits associated with these notes.

C. Findings and Conclusions

14. Evidence of irregularities or unreasonable decisions on the part of Prospect Mountain's board, or Mr. Heron acting on behalf of the Utility, may authorize the Commission to void the promissory notes to protect the Utility's assets and the interests of its ratepayers. *See* § 40-3-102, C.R.S.; *Montrose v. Public Utilities Com.*, 629 P.2d 619, 624 (Colo. 1981) ("The PUC has a general responsibility to protect the public interest regarding utility rates and practices."); *see also Colorado-Ute Electric Assoc. v. Public Utilities Com.*, 760 P.2d 627, 639 (Colo. 1988) ("As to matters specifically entrusted to management, the PUC may not assert itself absent an abuse of managerial discretion."); *Public Service Co. v. Public Utilities Com.*,

¹⁶ *See* Attachments 1 and 2 to Staff Audit, Proceeding No. 14A-0698W.

¹⁷ Attachment 2 to Staff Audit, 3-4.

¹⁸ Attachment 2 to Staff Audit, 18.

¹⁹ *Id.*, 2

653 P.2d 1117, 1123 (Colo. 1982) (“[T]he legal prerequisite to the exercise of its power over management is the finding that there has been an abuse of managerial discretion.”).

15. In response to the Staff’s inquiry, Prospect Mountain provided no evidence of: (1) the source of the deposits allegedly from Mr. Heron; (2) how the Utility spent the deposited money (*e.g.*, on operation and maintenance, capital improvements, or other expenses); (3) adequate management oversight over the loans, including their execution by Mr. Heron on behalf of the Utility to Mr. Heron as payee; and (4) the calculation of interest added to the principle amounts of the loans.

16. The evidence Prospect Mountain has provided indicates that the promissory notes are not consistent with ordinary utility business operations. While utilities commonly use short-term debt to finance business operations and use long-term capital investment to build infrastructure—all in the ordinary course of business—the promissory notes at issue here are fundamentally different. It appears that the shareholders repeatedly funded operations without any plan to make the Utility financially viable or to repay the loans. Therefore, the notes may not be valid liabilities of the Utility. *See* § 40-5-105, C.R.S. (requiring Commission approval for the sale, assignment, or lease of utility assets unless such action is conducted in the normal course of utility business).

17. Funding a failing utility over four decades with loan proceeds instead of Commission-approved rate increases may be evidence of shifting the costs of utility operations on to future ratepayers and thus an improper exercise of managerial discretion.

18. Consistent with the Commission determination in Proceeding No. 13A-0291W, that the encumbrances against the C-BT water rights were invalid, the evidence presented by Prospect Mountain in Proceeding Nos. 13A-0291W, 14A-0698W, and in response to the

Staff Audit provide a reasonable basis for Staff to pursue an order for Prospect Mountain to show cause why it has not acted in violation of statutes and Commission rules and decisions such that the outstanding promissory notes are void.

II. ORDER

A. The Commission Orders That:

1. Staff of the Colorado Public Utilities Commission shall propose an order to show cause to the Commission under Rule 1302(h) of the Rules of Practice and Procedure, 4 *Code of Colorado Regulations* 723-1. The proposed order would direct Prospect Mountain Water Utility to show cause why the promissory notes are not void.
2. The 20-day period provided for in § 40-6-114, C.R.S., to file application for rehearing, reargument, or reconsideration shall begin on the first day following the effective date of this Order.
3. This Decision is effective on its Mailed Date.

**B. ADOPTED IN COMMISSIONERS' WEEKLY MEETING
December 10, 2014.**

(S E A L)



ATTEST: A TRUE COPY

A handwritten signature in cursive script that reads "Doug Dean".

Doug Dean,
Director

THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF COLORADO

JOSHUA B. EPEL

PAMELA J. PATTON

GLENN A. VAAD

Commissioners