

PUBLIC UTILITY COMMISSION OF OREGON  
STAFF REPORT  
PUBLIC MEETING DATE: November 7, 2017

REGULAR \_\_\_\_\_ CONSENT X EFFECTIVE DATE \_\_\_\_\_ N/A

DATE: October 26, 2017

TO: Public Utility Commission

FROM: Stephanie Yamada *SY*  
*E*

THROUGH: Jason Eisdorfer, Bryan Conway, and Bruce Hellebuyck *BH*

SUBJECT: PETE'S MOUNTAIN WATER COMPANY, INC.: (Docket No. UP 352)  
Requests Approval for the Sale of All Capital Stock in Pete's Mountain  
Water Company, Inc., to PMWAC, Inc.

**STAFF RECOMMENDATION:**

The Public Utility Commission of Oregon (Commission) should approve the sale of Pete's Mountain Water Company, Inc. (Pete's Mountain or Company) to PMWAC, Inc. (PMWAC) subject to the following conditions:

1. Company shall provide the Commission access to all books of account as well as all documents, data, and records that pertain to the transfer of properties.
2. Company shall notify the Commission in advance of any substantive changes to the transfer of properties, including any material changes in price. Any changes to the agreement terms that alter the intent or extent of activities under the agreement from those approved herein, shall be submitted for approval in application for a supplemental order (or other appropriate form) in this docket.
3. PMWAC will provide notice to the Commission within 10 days of the close of the sale.

**DISCUSSION:**

Issue

Whether the Commission should approve the sale of all issued and outstanding capital stock in Pete's Mountain to PMWAC.

### Applicable Rule or Law

ORS 757.480(5) and OAR 860-036-2120(1) require water utilities doing business in Oregon to obtain Commission approval prior to disposing of the water utility. The Commission has traditionally applied a public interest “no harm” standard when considering whether or not to approve the transaction.<sup>1</sup>

Pursuant to OAR 860-036-2120(4), the utility must provide the Commission and its customers with notice of the sale no less than 60 days prior to the closing date of the transaction.

Pursuant to OAR 860-036-1950, when a rate-regulated water utility is restructured through the sale, merger, or transfer of the water system into an association that serves only its members, the water utility no longer meets the definition of a public utility under ORS 757.005, and is no longer subject to rate regulation. ORS 757.063 provides for the regulation of any association of individuals that furnishes water to members of the association in the same manner as provided by ORS chapter 757 if 20 percent or more of the members of the association file a petition for regulation.

### Analysis

Pete's Mountain is a privately owned, rate-regulated water utility serving approximately 90 customers in the vicinity of West Linn, Oregon. On September 15, 2017, Pete's Mountain filed an Application for Authority to Sell, Transfer, or Merge a Water Utility (Application), as required by ORS 757.480(5) and OAR 860-036-2120(1). The current owners of Pete's Mountain seek approval to sell all issued and outstanding capital stock in the Company to PMWAC. The Application states that the Company is being sold because Suzanne Webber, the President, majority shareholder, and operator of the system, wishes to retire. The proposed closing date of the transaction is November 15, 2017.

The Company currently has 500 shares of capital stock authorized, of which 100 shares are issued and outstanding. Ms. Webber owns 66 of these 100 outstanding shares, and the remaining 34 shares are owned by Becky Jones. The Stock Purchase Agreement (SPA) submitted with the Application has been signed by both of the Company's shareholders.

PMWAC, the purchaser, is a member-owned, not-for-profit corporation formed by customers of the utility for the purpose of acquiring the water system. Following the

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<sup>1</sup> See *In re Cline Butte Water, LLC*, OPUC Docket No. UP 345, Order No. 17-156 at 3-4 (May 1, 2017) (“[W]e apply a ‘no harm’ standard in approving water utility transfer applications”).

transfer of capital stock, Pete's Mountain will merge with and into PMWAC, Inc., and the name of the surviving corporation will be changed to Pete's Mountain Water Co., Inc. In this memorandum, the surviving company following the acquisition is referred to as New Pete's Mountain.

*1. Scope and Terms of the Stock Purchase Agreement*

With the exception of a 2008 Ford F150 pickup truck, all property owned by the Company is included in this transaction. This includes wells, water lines, pumping equipment, land, office equipment, software, and other assets. Staff reviewed the SPA and noted no unusual or restrictive terms to the agreement.

*2. Transfer Pricing and Allocation of Gain*

The sales price is \$350,000, and the Application states that the net book value of the water system is \$106,307.91. Because the proposed transaction is taking place between PMWAC and the Company's current shareholders, there is no gain or loss on the sale of assets to be recorded on the Company's accounting records. Furthermore, the bylaws of PMWAC, which were submitted with the Application, indicate that membership in PMWAC will be a requirement to receive water utility service following the ownership transfer. Pursuant to ORS 757.063 and OAR 860-036-1950, upon close of the sale, New Pete's Mountain will not be subject to either service or rate regulation by the Commission. As such, Staff does not find the issue of an acquisition adjustment to be relevant at this time. Should the utility return to rate regulation in the future, the appropriate rate base valuation would be considered at that time, as part of a general rate case proceeding.

*3. Public Interest Compliance*

Pete's Mountain and PMWAC have worked to keep customers informed regarding the proposed transaction, and no customers have voiced opposition to the proposal to the Commission. Pete's Mountain first informed customers of its intent to sell the water system in a letter to customers dated April 11, 2016, offering customers the option to purchase the system. Customers formed PMWAC, Inc., for the purpose of acquiring the water system.

PMWAC has held regular board meetings detailing its progress regarding the proposed transaction since May of 2016, and has made its meeting minutes available for public viewing on its website. PMWAC has also held multiple informational meetings for customers regarding the proposed transfer of ownership. PMWAC informs Staff that the most recent meeting, held on October 10, 2017, was attended by more than 40 out of 91 customer households, or approximately 44 percent of customers, and no significant objections regarding the proposed transfer of ownership were expressed by customers. Furthermore, a Report to Current Customers (included with the Application)

was sent to customers in September 2017, summarizing the effects of the proposed transaction, including the necessary system improvements to be undertaken and their associated costs, the status of water rights, the legal structure of the new ownership entity, the terms of financing acquired to purchase the system, the plan to operate the system, and the status of rates and fees following the ownership transfer. In compliance with OAR 860-036-2120(4), an official notice of the proposed sale was also mailed to customers on September 13, 2017. Staff has not been contacted by any customers of Pete's Mountain regarding the proposed transfer of ownership.

PMWAC plans to make a number of upgrades to the system, which it expects will benefit customers through system efficiencies, a more reliable water supply, and fewer water curtailment episodes during summer months. The proposed improvements include the installation of a backup generator, the replacement of the broken pump in well #1, the addition of automated water level monitoring and controls for well pumps, reservoir, and water pressure systems, and the replacement of existing customer meters with remote readable meters. The estimated total cost of the planned improvements ranges from \$290,000 to \$325,000. Customers have been made aware of the proposed improvements, and PMWAC states that no significant objections have been expressed.

In order to become familiar with normal system operation and costs following the transfer of ownership, PMWAC will not adjust water service rates for at least six months following its acquisition of the utility. However, PMWAC expects operating expenses to decrease compared to current levels. While the utility will not be subject to rate regulation following the transfer of ownership pursuant to OAR 860-036-1950, the utility's cost of service would be examined during a general rate proceeding if the utility were ever to return to rate regulation.

PMWAC proposes to introduce two new fees, which will initially be charged in addition to current water service rates. The Initial Membership Fee is a one-time fee of \$1,500, and is required in order to become a member of the utility. As PMWAC's bylaws specify that only members will be eligible to receive water service, all current customers will need to pay this fee in order to maintain service. The Report to Current Customers explains that this fee is necessary because PMWAC's "ownership will commence during the low-usage, low-revenue time of the year" and that "the new company's routine monthly costs will likely exceed water usage fees" during this time of the year. As such, the newly-formed PMWAC wishes to establish a reserve of funds to use toward unanticipated costs during the coming winter and spring months. The Report to Current Customers states that "if revenues accumulate beyond projected needs, excess funds may be rebated to members or applied to reduce monthly charges." Furthermore, customers who are unable to pay the \$1,500 fee as a lump sum will be eligible to pay

the fee under a time payment plan. Staff is not aware of any customers who are opposed to this proposal.

Assuming that 90 customers pay the Initial Membership Fee, the fee will provide PMWAC with \$135,000 to begin its operation of the utility. Although PMWAC has secured a loan in the amount of \$680,000 (discussed below), those funds will be used toward the purchase price and planned system improvements. PMWAC's balance sheet was submitted with the Application, showing a total cash balance of \$661.84 as of August 31, 2017. PMWAC will require a reserve of funds on hand to address any unexpected costs during the transition period, and to compensate for the low revenues achieved during the present low-usage time of year. The funds acquired through the Initial Membership Fee will essentially function as a reserve fund, which the Commission has approved previously for nonprofit water utilities. For example, in UW 149, the Commission approved a reserve fund equal to six months of operating expenses, or \$259,438, for Crooked River Ranch Water Company. While the "Operating Reserve Policy Toolkit for Nonprofit Organizations" recommends that a reserve fund contain a minimum amount equal to three months' expenses, it also stresses that the amount should be increased depending on external risk factors faced by the organization.<sup>2</sup> Since PMWAC will immediately begin incurring costs upon the transfer of ownership, and will likely face some uncertainty in costs during the transition period, Staff finds that the proposed reserve fund is necessary. In light of the financial safeguards it provides, the possibility of refunding customers any excess revenues, the ability for customers to establish a time payment plan and the apparent general support from customers, Staff does not find the proposed Initial Membership Fee to be contrary to the public interest.

Additionally, PMWAC proposes to introduce a monthly fee of \$29.00 for 240 months, which will be used to pay the loan secured through the Oregon Health Authority's Safe Drinking Water Revolving Loan Fund. The total loan amount is \$680,000, with \$234,000 immediately forgiven. The remaining \$446,000 is to be paid with annual interest of 2.15 percent over a term of 20 years. The purpose of the loan is to cover the \$350,000 purchase price as well as the approximately \$300,000 in planned system improvements, as described above.

PMWAC also proposes to introduce a Transfer Fee, which will be charged to new owners of property within the service territory who desire to acquire membership by transfer from the previous owner. The Transfer Fee is intended to cover the costs associated with performing a membership transfer, including confirming the payment

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<sup>2</sup> Operating Reserve Policy Toolkit for Nonprofit Organizations, First Edition, September 15, 2010, sponsored by the National Center for Charitable Statistics, Center on Nonprofit and Philanthropy at the Urban Institute, and United Way Worldwide, page 16-17.

status of the current owner, securing written commitments for service and membership from the new owner, final meter reading, updating billing and company records, and other related tasks. The Transfer Fee will initially be set at \$250 per transfer, but PMWAC may adjust this amount at a later time if experience in operating the system proves that the fee does not properly align with costs.

The Application states that PMWAC will contract with Merrill Water Systems LLC to provide day-to-day management of the system operations. Merrill Water Systems provides a range of services necessary for water system operation, including scheduling water quality tests, collecting water samples, system planning, and well and pump maintenance. The company originally opened as Merrill Well Drilling in 1978, and now provides a range of services in Marion, Polk, Yamhill, and Clackamas counties.

While New Pete's Mountain will not be subject to rate regulation pursuant to OAR 860-036-1950, customers will retain their right to petition the Commission for rate regulation at any time pursuant to ORS 757.063 and OAR 860-036-1930.

Should the petition for rate regulation be granted, given the lack of return on equity, the loan forgiveness, the proposed capital additions, and the expected reduction in operating expenses referenced above, Staff believes that New Pete's Mountain would have rates lower than would be present if the sale did not occur. Furthermore, if the sale to PMWAC did not occur and no other potential buyers could be identified, the current owner of the utility would either need to pay for someone else to run the company, which would add additional costs to customers, or seek approval to abandon the system. Because such a scenario could be harmful to customers, and because a significant portion of customers have expressed support of the plans laid out in the Application, Staff finds the proposed transfer of ownership to be in the public interest.

#### *4. Records Availability, Audit Provisions, and Reporting Requirements*

Prior to the close of the sale, the Company will continue to provide the Commission access to all books of account as well as all documents, data, and records that pertain to the transfer of properties.

#### Conclusion

Staff concludes that the sale of all capital stock in Pete's Mountain to PMWAC meets the public interest, no harm standard and should be approved.

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**PROPOSED COMMISSION MOTION:**

Approve the sale of all capital stock in Pete's Mountain to PMWAC, subject to the conditions stated in Staff's recommendations in this memorandum.

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