


PUBLIC UTILITY COMMISSION OF OREGON
STAFF REPORT
PUBLIC MEETING DATE: November 22, 2016

REGULAR CONSENT EFFECTIVE DATE _____ N/A

DATE: October 28, 2016

TO: Public Utility Commission

FROM: Greg Miller 

THROUGH: Jason Eisdorfer, Bryan Conway, and Bruce Hellebuyck 

SUBJECT: SUNRIVER WATER, LLC: (Docket No. UI 378) Requests approval of an Affiliated Interest Agreement with Sunriver Resort Limited Partnership.

STAFF RECOMMENDATION:

The Public Utility Commission of Oregon (Commission) should approve Sunriver Water, LLC's (Sunriver Water or Company) application for approval of a Management Agreement (Agreement) with Sunriver Resort Limited Partnership (Resort or Affiliate), an affiliated interest, as modified in this memorandum and subject to the following conditions:

1. The Company will provide the Commission access to all books of account as well as all documents, data, and records that pertain to any transactions involving the Resort.
2. The Commission reserves the right to review, for reasonableness, all financial aspects of these transactions in any rate proceedings or alternative form of regulation.
3. The Company will notify the Commission in advance of any substantive changes to the Agreement, including any material change in price. Any such changes shall be submitted in an application for a supplemental order (or other appropriate format) in this docket.
4. The Company will report to the Commission, as part of its annual affiliated interest report, a summary of the Company's transactions with the Resort.

DISCUSSION:

Issue

Whether the Commission should grant the Company's request to enter into an Agreement with the Resort, an affiliated interest, for goods and services provided by the Resort to Sunriver Water.

Applicable Law

A corporation or person has an "affiliated interest" with a public utility when it owns or holds, directly or indirectly, at least five percent of the voting securities of that public utility. See ORS 757.015. When a public utility enters into a contract with an affiliated interest, it must seek Commission approval of the contract within 90 days of execution of the contract. See ORS 757.495. Further, OAR 860-036-0739(4)(e) requires that affiliated interest transactions be priced at the lower of cost or market rate.

The Commission will approve affiliated interest agreements if the terms are fair and reasonable and not contrary to the public interest. See ORS 757.495(3). However, the Commission need not determine the reasonableness of all financial aspects of the agreement for ratemaking purposes, and may reserve that issue for subsequent proceedings. See Order No. 11-071 (Docket No. UI 306).

Analysis

The Company is a water utility that provides service to approximately 4,700 customers in a community consisting of full and part-time residences, multi-family condominiums, a resort hotel, commercial areas, golf courses, and recreational facilities. The Resort is organized as a limited partnership and holds 100 percent of the equity interest of Sunriver Water.

Pursuant to ORS 757.015 and ORS 757.495, Sunriver Water filed an affiliated interest application on August 26, 2016. The application was filed in the manner and form required by OAR 860-036-0730. The Agreement between Sunriver Water and the Resort establishes the terms and conditions under which services are provided. The Resort will, among other things, provide all financial and accounting-related duties, all employment management-related duties, all information technology and telecommunication service and support functions, execution of all contracts on behalf of the Company, all insurance and risk management duties, and all executive-related oversight of the Company. The initial term of the Agreement is from August 1, 2016 to December 31, 2025, and shall automatically renew for successive five-year periods after December 31, 2025, unless either party elects not to renew the Agreement. The Agreement also allows for payment increases each January 1, equal to the relative

change in the Consumer Price Index (All Urban Consumers CPI-U) from January 1 of the previous year through December 31 of the previous year.

Staff investigated the following issues in determining whether the Agreement is fair, reasonable, and not contrary to the public interest:

1. Terms and Conditions of the Agreement;
2. Transfer Pricing;
3. Public Interest Compliance; and
4. Records Availability, Audit Provisions, and Reporting Requirements.

Terms and Conditions of the Agreement

Staff reviewed the Agreement between Sunriver Water and the Resort and has no issues or concerns at this time. Should the terms or conditions of the Agreement significantly change or prove unreasonable to customers; Staff will be able to address the impacts in the Company's next rate application as recommended in ordering condition 2.

Transfer Pricing

In the Company's application, Sunriver Water lists a total annualized management cost of \$292,229. The breakdown of the management cost is allocated as follows:

- Accounting Department Costs \$83,947
- Allocated HR Costs \$15,671
- Allocated IT Costs \$52,528
- Executive Management Costs \$67,844
- Senior Management Costs \$34,739
- Affiliated Management Fee \$37,500

Staff reviewed all costs associated with the Agreement to determine if the amount paid by the Company to the Affiliate was the lower of cost or market rate as required by OAR 860-036-0736. According to the Company, an internal study was completed, which examined the hours and wages needed to fulfill each of the responsibilities outlined in the Agreement. The Company states that over the course of the last 45 years, it has been able to more efficiently operate by being able to utilize the management functions of the Resort. Staff agrees with the Company that absent this relationship, the Company would be required to hire additional staff to perform all of these duties, thus eliminating the benefits from economies of scale. For example, rather than utilizing the Resort's IT personnel on an as-needed basis, the Company would be required to add staff to handle IT matters. The Company also states that the

wages associated with all Resort employees performing under the Agreement are market wages without any markup.

Staff also examined the Company provided market alternatives. The Company obtained a market wage analysis report prepared by Oregon Employment Department's Oregon Labor and Market Information System (OLMIS). Sunriver Water believes two full-time and two part-time positions would be required to satisfy the functions of the Agreement. Table 1 shows the market positions and salaries indicated in the Company's application.

Table 1

Occupation	Median or Average Hourly	Loaded 30%¹	Annual Hours	Annual Wage
Full Charge Bookkeeper	\$27.83	\$36.18	2080	\$75,252.32
Human Resource/Benefit Administration	\$44.22	\$57.49	1040	\$59,785.44
IT Contract Services/Systems Maintenance	\$47.11	\$61.24	1040	\$63,692.72
General Manager	\$63.16	\$82.11	2080	\$170,784.64
Estimated Tax Prep & Accounting Services				\$15,000.00
Total				\$384,515.12

Table 2 shows Staff's analysis of the market positions and annual wage amounts needed to provide the necessary services in the Agreement. Staff used the OLMIS and American Water Works Association (AWWA) Water Utility Compensation Survey as a proxy, as well as other water rate-regulated company positions to determine the market rate for individual employee wages. After examining all positions, Staff calculated a lower required market wage outlay than what Sunriver Water provided, but still in excess of the Company's proposed costs in the Agreement.

¹ Sunriver Water applies a 30% loading for taxes and benefits.

Table 2

Occupation	Median or Average Hourly ²	Loaded 30%	Annual Hours	Annual Wage/Cost
Accountant & Auditor	\$27.83	\$36.18	2080	\$75,252.32
Human Resource Manager	\$44.22	\$57.49	1040	\$59,785.44
Computer & IT Systems Manager	\$47.11	\$61.24	1040	\$63,692.72
General & Operations Manager ³	\$39.67	\$51.57	2080	\$107,267.68
Tax Preparation & Accounting Services ⁴				\$12,935.00
Total				\$318,933.16

The Company also provided a second market analysis approach in its application, examining two other comparable rate-regulated water companies in the Central Oregon area.⁵ The Company states costs for similar services provided in the management agreement were obtained from each company's most recently filed annual report. Table 3 shows the customer count, administrative cost, and annual water cost per ratepayer for each company. Staff verified this information and also added an additional rate-regulated company to the table, Cline Butte, which also has a management agreement currently in place.

Table 3

Company	Customer Count ⁶	Administrative Cost per Rate-Payer ⁷	Annual water cost per Rate-Payer
Sunriver	4,762	\$61	\$361
Avion	13,251	\$48	\$614
Roats	1,866	\$150	\$575
Cline Butte	1,606	\$78	\$759
Average Cost		\$84	\$577

² Staff used the lowest of the three market sources.

³ Staff used the lower of the two General Manager positions provided by OLMIS.

⁴ Average 2015 accounting costs paid by Avion and Roats.

⁵ The companies examined were Avion Water Company and Roats Water System Inc.

⁶ Year-end customer counts taken from each Company's 2015 annual report filed with the Commission.

⁷ Calculations based on amounts from annual reports.

Sunriver Water notes in its application that the result of this exercise indicates the proposed management fee represents an administrative annual cost of \$61 per user, which is well within the comparable range of the other water companies. The Company also states that the overall annual average water cost per user for the 2015 calendar year was lower than any other comparable water company in their analysis, further indicating fiscal conservancy.

Table 4 shows Staff's proposed adjustments and annual cost allocation amounts. Staff recommends allowing both the Executive and Senior Management functions within the Agreement, noting the combined management salaries would be lower than the expense of hiring an external General Manager. As indicated in Table 4, Staff recommends lowering the overall cost associated with the Agreement. Staff removed the cost related to the Affiliate Management Fee. The Affiliate Management Fee is more formally named in the application as a Destination Hotels Annual Utility Companies Management Fee. The fee includes administration, technical support, systems maintenance, software, and data warehousing. Staff feels these duties can be performed within the IT/Telecommunications function as well as other administrative areas included in the Agreement.

Table 4

Management Costs	Company proposed Cost	Staff proposed Cost
Accounting Department	\$83,947	\$83,947
Allocated HR	\$15,671	\$15,671
Allocated IT	\$52,528	\$52,528
Executive Management	\$67,844	\$67,844
Senior Management	\$34,739	\$34,739
Affiliate Management Fee	\$37,500	\$0
Total Annualized Management Agreement Cost	\$292,229	\$254,729

Staff recommends that the Commission approve an annual Agreement amount of \$254,729. This recommendation represents a reasonable outcome for both the Company and its customers. Customers would receive a 13 percent reduction (from \$292,229 to \$254,729) in Company proposed management costs, and the Company would retain use of the internal management functions currently in place at a lower than market cost.

Public Interest Compliance

The Commission customarily applies a no harm standard to affiliated interest agreements. Staff believes the Agreement is consistent with the public interest, and that customers will benefit by administrative and management efficiencies achieved through the Affiliate relationship. Absent the Agreement, the Company would be required to seek external management services, which would result in higher costs for ratepayers.

Records Availability, Audit Provisions, and Reporting Requirements

Staff notes that the Commission retains the ability to review all affiliated transactions of the Company through its annual affiliated interest report and general rate case filings. Staff's recommended conditions allow Commission examination of the Company records concerning the Agreement.

Conclusion

Based on the review of this application, Staff concludes the following:

1. With inclusion of Staff's recommended ordering conditions, the proposed affiliated interest agreement is fair and reasonable and not contrary to the public interest; and
2. Necessary records are available.

PROPOSED COMMISSION MOTION:

Approve Sunriver Water's application for approval of a Management Agreement with the Resort, subject to the four recommended conditions.