

ORDER NO. **17 168**

ENTERED MAY 16 2017

**BEFORE THE PUBLIC UTILITY COMMISSION
OF OREGON**

UP 346

In the Matter of

OREGON RESORTS, LLC (RUNNING Y
WATER, LLC, a wholly-owned subsidiary of
OREGON RESORTS, LLC)

Application for the Sale, Transfer, or Merger
of a Water Utility to SouthWest Water
Company.

ORDER

DISPOSITION: STAFF'S RECOMMENDATION ADOPTED

At its public meeting on May 16, 2017, the Public Utility Commission of Oregon adopted Staff's recommendation in this matter. The Staff Report with the recommendation is attached as Appendix A.

BY THE COMMISSION:



A handwritten signature in blue ink, appearing to read "Michael Dougherty", is written over a horizontal line.

Michael Dougherty
Chief Operating Officer

A party may request rehearing or reconsideration of this order under ORS 756.561. A request for rehearing or reconsideration must be filed with the Commission within 60 days of the date of service of this order. The request must comply with the requirements in OAR 860-001-0720. A copy of the request must also be served on each party to the proceedings as provided in OAR 860-001-0180(2). A party may appeal this order by filing a petition for review with the Circuit Court for Marion County in compliance with ORS 183.484.

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ITEM NO. CA9

PUBLIC UTILITY COMMISSION OF OREGON
STAFF REPORT

PUBLIC MEETING DATE: May 16, 2017

REGULAR _____ CONSENT X EFFECTIVE DATE May 17, 2017

DATE: May 2, 2017

TO: Public Utility Commission

FROM: Malia Brock MB

THROUGH: Jason Eisdorfer, Bryan Conway, and Bruce Hellebuyck
JE BH by BH

SUBJECT: OREGON RESORTS, LLC: (Docket No. UP 346) Application for Approval of the Sale of Running Y Water, LLC to SouthWest Water Company.

STAFF RECOMMENDATION:

Staff recommends that the Commission approve the sale of Running Y Water, LLC (Running Y, or New Running Y when referred to post-acquisition) to SouthWest Water Company (SouthWest) subject to the terms listed in Appendix A.

DISCUSSION:

Issue

Whether the Commission should approve the sale of Running Y to SouthWest.

Applicable Rule or Law

Oregon Revised Statute (ORS) 757.480(5) and Oregon Administrative Rule (OAR) 860-036-2120(1) require water utilities doing business in Oregon to obtain Commission approval prior to the sale of the water utility.

The Commission has traditionally applied a public interest "no harm" standard when considering whether or not to approve the transaction.¹

¹ 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").

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Analysis

Oregon Resorts is an affiliate of Northview Hotel Group (NVHG) which owns and manages Running Y. Running Y is a rate-regulated water utility owned by Oregon Resorts, LLC. The utility provides water service to the Running Y Ranch resort community located approximately 8 miles north of Klamath Falls. Current Running Y Ranch customers include the hotel, a golf course and approximately 600 residential customers situated on 3,600 acres. The sale includes the water utility system serving the RidgeWater community situated a few miles away. RidgeWater has approximately 16 completed homes in an amenitized community planned for 650 home sites on 1,400 additional acres. Running Y's sister utility, Running Y Environmental, LLC, provides wastewater to these same customers. Per ORS 757.061, Running Y is subject to Commission regulation, but Running Y Environmental, LLC, is unregulated.

1. The Sale

On October 21, 2016, Oregon Resorts, LLC (Oregon Resorts) filed an Application for Approval of the Sale of Running Y to SouthWest Water Company (Application). The underlying Asset Purchase Agreement (APA), signed September 27, 2016, includes Cline Butte Water, LLC and Running Y Water, LLC (both rate-regulated water utilities) and Cline Butte Environmental, LLC and Running Y Environmental, LLC (both unregulated wastewater companies). Oregon Resorts and SouthWest considered the transaction to be an aggregate purchase, and therefore the sale is contingent on the Commission's approval of the associated sale of Cline Butte Water. The Commission approved the sale of Cline Butte Water, LLC to SouthWest in OPUC Order No. 17-156.

Running Y property affected by the sale will include all assets, real or personal, owned or titled in the name of Running Y and utilized in the provision of water service to its customers. This sale encompasses three deep-water wells at Running Y Ranch (only two of which are in production as one well was impacted by performance) and one storage reservoir, which also houses a booster station on the same land parcel. The sale also includes the water system facilities serving the RidgeWater community consisting of one deep-water well, one storage reservoir, and one booster station.

2. Scope and Terms of the Asset Purchase Agreement

Running Y is wholly owned by Oregon Resorts, LLC. The sale is a privately-negotiated, non-auction sale. The purchase price is considered confidential and not included in this public meeting memorandum, but has been provided to the Commission. The terms of the sale do not include any unusual restrictive terms or conditions.

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3. Transfer Pricing and Allocation of Gain

SouthWest has agreed it will not seek rate recovery related to any potential acquisition adjustment in its purchase of Running Y. That agreement is reflected as Term 2 contained in the Term Sheet attached as Appendix A; additionally, Term 18 excludes any transactions costs from rates.

4. Public Interest Compliance

Oregon Resort's primary focus is on the ownership and management of hotel and resort properties; managing utilities is not part of its core business strategy. Oregon Resorts desires to sell the utility property in order to divest itself of operations that are not primary assets of its core business. Oregon Resorts identified SouthWest as having extensive experience successfully managing and operating water utilities throughout the country to continue to provide safe, reliable, high-quality service at reasonable rates to customers.

SouthWest is owned by an open-ended, perpetual life investment fund with a long-term "hold" investment strategy. The investment strategy of the fund places emphasis on mature entities and low volatility. Its investors, which include pension funds and other entities looking for stable, long term investments, share this long-term "hold" investment philosophy.

SouthWest has a long history of effectively owning and operating water systems and has annual revenues of \$143.6 million and a netbook value in excess of \$367 million.

SouthWest has access to capital to finance the current operations and future capital expenditure requirements and holds a BBB rating with Standard & Poor's rating agency on secured debt.

In short, Running Y will be operated by a professional utility with extensive experience in all facets of water system operation; infrastructure construction and design, safe water, excellent customer service, maintaining and operating water systems, and managing a financially sound utility.

Appendix A contains several terms designed to protect Oregon consumers and comply with ORS 757.480(5) and the public interest, "no harm" standard. Staff notes that SouthWest and Oregon Resorts have agreed to these terms, which mirror the terms stipulated to by the UP 345 parties and adopted by the Commission in Order No. 17-156.²

² Order No. 17-156 at Appendix A.

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a. Rate Impacts

In Term 1, SouthWest commits that New Running Y will not file a general rate case for prior to 23 months from the closing of the transaction. This stay-out provision ensures that costs incurred by the Seller will not be used as the basis for rates when New Running Y files its next general rate case. Rather, New Running Y will have a complete calendar year under new ownership in which it will record its costs. This stay-out clause will allow SouthWest to seek and implement operational efficiencies in New Running Y operations before filing a general rate case. Filing a general rate case based on updated costs will allow rates to be charged to customers based on a more accurate cost of service than otherwise, and is a benefit to customers. Term 4 reserves the right to review all financial aspects of the purchase approved in UP 346 in any rate proceeding or earnings review. Term 18 ensures transaction costs will be excluded from rates.

b. SouthWest Will Not Advocate for a Higher Cost of Capital

Terms 16 through 17 protect New Running Y customers from any cost of capital effects. Term 16 ensures New Running Y has adequate capital to fulfill all of its public utility service obligations; Term 17 protects New Running Y customers from a higher cost of capital than New Running Y would have incurred absent SouthWest ownership. Additionally, Term 2 is SouthWest's commitment to not request an acquisition adjustment related to its purchase of Running Y. Customers will not be held responsible for the difference between the purchase price of Running Y, and original cost, less accumulated depreciation, accumulated amortization, and contributions in aid of construction.

c. Affiliated Interest Protection

Several terms address protections relating to affiliated interests to provide transparency and ensure customers will not be harmed by the transaction. Terms 5 and 8 require New Running Y to abide by ORS statute and OAR 860-036-2200, 2210, and 2230 rules when recording affiliate interest transactions and filing applications of all affiliated interests within 90 days following the close of sale. Term 6 reflects SouthWest's commitment that New Running Y will not request in its next general rate case more than Running Y is currently reporting for affiliated interest transactions according to its 2015 annual report of operations filed with the Commission. Term 7 also relates to affiliated interests, and states that the Commission will have access to review all of SouthWest's books and records related to its affiliated interest transactions with New Running Y, as well as SouthWest's subsidiary Suburban Water Systems' affiliated interest transactions with New Running Y which will be reviewed in the next rate case.

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d. Ring-Fencing Protection

Ring-fencing provisions are addressed in Terms 9 through 15. These include requirements that SouthWest and New Running Y remain separate legal and financial entities, with separate books and records. Further, New Running Y will not issue short-term loans to SouthWest or its affiliates under terms not available to third parties and shall not issue, secure, or guarantee the debt of SouthWest or its affiliates. The ring-fencing provisions included in these terms help ensure New Running Y customers will not be harmed by circumstances affecting Southwest and its other operating units. In other words, the ring-fencing ensures New Running Y is viewed as a stand-alone utility rather than a division of SouthWest.

e. Service Impacts

Terms 19 through 21 ensure customers of New Running Y will not be negatively impacted by the transition of ownership, as relates to customer service. SouthWest will maintain a local workforce, and in addition will provide customers access to online bill-payment options and a dedicated customer service center within one year of closing.

The terms in Appendix A and described above mitigate risks to customers by enacting ring-fencing provisions; ensuring the Commission has adequate access to information; maintaining a local presence and local employees; excluding goodwill from rates (prohibition on requesting an acquisition adjustment) and provides benefits not necessarily linked to a risk to help offset any unmitigated risks. These benefits include a general rate case stay-out, a cap on affiliated interest charges, improved customer service through a 24/7 hotline and the acceptance of online payments. Subject to the terms in Appendix A, Staff believes that the transaction meets the no harm standard.

5. *Records Availability, Audit Provisions and Reporting Requirements*

Terms relating to record availability, audit provisions and reporting requirements are also provided for in Appendix A, which lists terms covering separations of affiliate and parent costs, record availability and recording transactions.

- a. Term 3 states that Running Y will submit to the Commission prior to closing its December 31, 2016 balance sheet and 2016 annual income statement, as well as schedules L and M from its 2016 Federal Tax Return. This term supports the Commission's goal of transparency. This term also supports the right of the Commission, as reiterated by Term 4, to review all aspects of the transaction in a rate proceeding.

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- b. Term 7 provides that the Commission will have access to review all of SouthWest's books and records relating to its affiliated interest transactions with New Running Y, as well as SouthWest's subsidiary Suburban Water Systems' affiliated interest transactions with New Running Y. Term 12 agrees New Running Y books and records shall be available in accordance to applicable systems of accounts or generally accepted accounting principles.
- c. Terms 9 through 15 provide safeguards to ensure New Running Y does not bear costs directly associated with operations outside of the state of Oregon by maintaining accounting structures that distinguish Oregon operations, provide review of costs and track corporate function costs. The terms are designed to ensure SouthWest and New Running Y maintain separate legal entities and records. Term 11 agrees that New Running Y will maintain separate financial statements showing its assets and liabilities on a stand-alone basis.

Conclusion

Staff concludes that the sale of Running Y Water, LLC to SouthWest Water Company meets the public interest, no harm standard and should be approved subject to the terms set forth in Appendix A.

PROPOSED COMMISSION MOTION:

Approve the sale of Running Y Water, LLC, to SouthWest Water Company subject to the terms listed in Appendix A.

RunningY.UP346

APPENDIX ADOCKET UP 346 TERM SHEETTERM 1.

SouthWest agrees that New Running Y (Running Y when referred to post-acquisition) will not file a general rate case prior to twenty-three months of the closing of the acquisition. New Running Y will not file to increase any of its rates, charges, or fees prior to its first general rate case filing.

TERM 2.

SouthWest agrees New Running Y will not seek rate recovery related to any potential acquisition adjustment due to its purchase of Running Y. The term "acquisition adjustment" to be defined by NARUC's published 1996 Uniform System of Accounts for Class B Water Utilities, account 114 – Utility Plant Acquisition Adjustments and that any amounts booked to account 114 – Utility Plant Acquisition Adjustment will be amortized and excluded from cost of service. SouthWest will use the accounting instructions prescribed in Section 16 Utility Plant – Purchased to record the acquisition. See Appendix B.

TERM 3.

Oregon Resorts agrees that, prior to Closing, Oregon Resorts will provide the following:

- a. Running Y's ending balance sheet as of 12/31/16;
- b. Running Y's annual income statement for 2016 and its related depreciation and CIAC schedules; and
- c. Running Y's Schedules L and M from its 2016 Federal Income Tax Return.

TERM 4.

SouthWest agrees that OPUC approval of this application does not imply that the Running Y assets not reviewed in a prior Running Y rate proceeding are deemed prudent by approval of this transaction; however Commission approval does imply that any such assets will be subject to evaluation in the next general rate case or other similar proceeding.

TERM 5.

SouthWest agrees New Running Y will file affiliated interest applications under ORS 757.495 and OAR 860-036-2210 within 90 days of closing for any transactions involving affiliates.

TERM 6.

SouthWest agrees New Running Y will not seek rate recovery for more than \$53,397 annually for affiliated interest costs charged by SouthWest and Suburban to New Running Y in the first general rate case or similar proceeding filed by New Running Y.

TERM 7.

SouthWest agrees to provide the Commission with access to all books and records of SouthWest and Suburban that pertain to affiliated transactions that pertain to New Running Y between SouthWest and New Running Y, Suburban and New Running Y, or Suburban and SouthWest.

TERM 8.

SouthWest agrees that New Running Y will comply with OARs 860-036-2200, 2210 and 2230 when recording affiliate transactions on its books and records.

1 TERM 9.

2 SouthWest will maintain the following structural and procedural safeguards to ensure that new
3 Running Y customers do not bear costs directly and solely associated with operations outside of
4 the state of Oregon:

- 5 a. SouthWest will maintain an accounting structure that will distinguish the
6 operations in Oregon utilizing a distinct company code and utility-specific cost
7 centers.
8 b. Costs that are incurred and recorded to the Oregon cost centers will be reviewed
9 for inclusion by employees at the appropriate level.
10 c. Accountants will perform detailed review procedures during the monthly closing
11 process for the appropriateness of costs recorded in the Oregon operations.
12 d. SouthWest corporate functions cost will be tracked in corporate cost centers and
13 reviewed and approved to ensure that amounts do not represent a direct cost of
14 any operation.

15 TERM 10.

16 SouthWest agrees that New Running Y and its parent shall be separate legal entities.

17 TERM 11.

18 SouthWest agrees that New Running Y shall maintain separate financial statements showing
19 its assets and liabilities on a stand-alone basis and may be included in the consolidated
20 financial statements of its parent for financial reporting purposes.

TERM 12.

SouthWest agrees that New Running Y books and records shall be available in accordance with the applicable uniform system of accounts or, as appropriate, generally accepted accounting principles.

TERM 13.

New Running Y shall not issue, secure or guarantee the debt of any other SW Merger Acquisition Corp Company.

TERM 14.

SouthWest agrees that New Running Y shall not make any short-term loans to any other SW Merger Acquisition Corp companies, except on terms that are substantially similar to those that would be available on an arms-length basis with unrelated third parties.

TERM 15.

SouthWest agrees that New Running Y shall maintain its assets and liabilities, and books and records relating thereto, in such a manner that ascertaining or identifying its individual assets and liabilities as separate and distinct from those of its parent will not entail significant costs or difficulty.

TERM 16.

SouthWest shall ensure that New Running Y has adequate capital to fulfill all of its public utility service obligations.

TERM 17.

SouthWest commits New Running Y will not advocate for a higher cost of capital than would have prevailed for Running Y absent SouthWest ownership.

1 **TERM 18.**

2 SouthWest agrees that New Running Y will exclude transaction costs from rates.

3 **TERM 19.**4 SouthWest agrees that New Running Y customers will enjoy the same access to local
5 employees currently enjoyed by Running Y customers.6 **TERM 20.**7 SouthWest agrees that New Running Y customers will have access to on-line bill payment
8 capabilities within one year after closing.9 **TERM 21.**10 SouthWest agrees that New Running Y customers will have access to Suburban's call center
11 within one year after closing.

UNIFORM SYSTEM OF ACCOUNTS FOR CLASS B WATER UTILITIES

1996



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NATIONAL ASSOCIATION OF
REGULATORY UTILITY
COMMISSIONERS16. Utility Plant - Purchased or Sold

A. When utility plant constituting an operating unit or system is acquired by purchase, merger, consolidation, liquidation, or otherwise, the costs of acquisition, including expenses incidental thereto properly includible in utility plant, shall be charged to account 104 - Utility Plant Purchased or Sold.

B. The accounting for the acquisition shall then be completed as follows:

- (1) The original cost of plant, estimated if not known, shall be credited to account 104 - Utility Plant Purchased or Sold, and concurrently charged to the appropriate utility plant in service accounts and account 102 - Utility Plant Leased to Others and account 103 - Property Held for Future Use, and account 105 - Construction Work in Progress, as appropriate.
- (2) The requirements for accumulated provision for depreciation and amortization applicable to the original cost of the properties purchased, if required by the Commission to be recorded by the accounting utility determined with due regard to operating practices of the purchaser and his plans regarding such property, and giving consideration also to the effect on such requirements of any rehabilitation expenditures (see Paragraph C), shall be charged to account 104 - Utility Plant Purchased or Sold, and concurrently credited to the appropriate account for accumulated depreciation or amortization.
- (3) The cost to the utility of any nonutility plant shall be transferred to account 121 - Nonutility Property.
- (4) The amount of contributions in aid of construction applicable to the property acquired, and which the purchaser may be required to record, shall be charged to account 104 - Utility Plant Purchased or Sold, and concurrently credited to account 271 - Contributions in Aid of Construction.
- (5) The amount of accumulated amortization applicable to contributed property, and which the purchaser may be required to record, shall be credited to account 104 - Utility Plant Purchased or Sold and concurrently debited to account 272 - Accumulated Amortization of Contributions in Aid of Construction, according to the regulatory treatment of the Commission.

- (6) The amount remaining in account 104 - Utility Plant Purchased or Sold, shall then be closed to account 114 - Utility Plant Acquisition Adjustments.

C. If property acquired in the purchase of an operating unit or system is in such physical condition when acquired that it is necessary substantially to rehabilitate it in order to bring the property up to the standards of the utility, the cost of such work, except replacements, shall be accounted for as a part of the purchase price of the property.

D. When any property acquired as an operating unit or system includes duplicate or other plant, which will be retired by the accounting utility in the reconstruction of the acquired property or its consolidation with previously owned property, the accounting for such property shall be presented to the Commission.

E. In connection with the acquisition of utility plant, the utility shall procure, if possible, all existing records relating to the property acquired, or certified copies thereof, and shall preserve such records in conformity with regulations or practices governing the preservation of records of its own construction.

F. When utility plant constituting an operating unit or system is sold, conveyed, or transferred to another by sale, merger, consolidation, or otherwise, the book cost of the property sold or transferred to another shall be credited to the appropriate utility plant accounts, including amounts carried in account 114 - Utility Plant Acquisition Adjustments, and the amounts (estimated if not known) carried with respect thereto in the accounts for accumulated depreciation and amortization and in account 252 - Advances for Construction, and account 271 - Contributions in Aid of Construction, shall be charged to such accounts and the contra entries made to account 104 - Utility Plant Purchased or Sold. Unless otherwise ordered by the Commission, the difference, if any between (a) the net amount of debits and credits and (b) the consideration received for the property (less commissions and other expenses of making the sale) shall be included in account 414 - Gains (Losses) From Disposition of Utility Property (See account 104 - Utility Plant Purchased or Sold).

Note:--In cases where existing utilities merge or consolidate because of financial or operating reasons or statutory requirements rather than as a means of transferring title of purchased properties to a new owner, the accounts of the constituent utilities, with the approval of the Commission, may be combined. In the event original cost has not been determined, the resulting utility shall proceed to determine such cost as outlined herein.

114. Utility Plant Acquisition Adjustments

A. This account shall include the difference between (a) the cost to the accounting utility of utility plant acquired as an operating unit or system by purchase, merger, consolidation, liquidation, or otherwise, and (b) the original cost, estimated, if not known, of such property, less the amount or amounts credited by the accounting utility at the time of acquisition to accumulated depreciation, accumulated amortization and contributions in aid of construction with respect to such property.

B. This account shall be subdivided so as to show the amounts included herein for each property acquisition and the amounts applicable to each utility department and to utility plant in service and utility plant leased to others (See Accounting Instruction 16) .

C. The amounts recorded in this account with respect to each property acquisition shall be amortized, or otherwise disposed of, as the Commission may approve or direct.