




Michael Dougherty
Chief

ITEM NO. CA2

PUBLIC UTILITY COMMISSION OF OREGON
STAFF REPORT
PUBLIC MEETING DATE: December 18, 2017

REGULAR _____ CONSENT X EFFECTIVE DATE _____ Upon Commission Approval¹

DATE: December 11, 2017

TO: Public Utility Commission

FROM: Malia Brock MB

THROUGH: Jason Eisdorfer, Bryan Conway, and Bruce Hellebuyck

SUBJECT: SQUAW CREEK CANYON DEVELOPMENT:
(Docket No. UP 358) Requests Approval for the Sale of a Water Utility to Avion Water Company, Inc., and Waiver of OAR 860-036-2120(4).

STAFF RECOMMENDATION:

Staff recommends that the Commission approve the sale of Squaw Creek Canyon Development (Creek Development) water utility to Avion Water Company, Inc. (Avion or Company) and grant the request for waiver of OAR 860-036-2120(4) subject to the following conditions:

1. Avion shall notify the Commission of any substantive changes to the terms of the December 6, 2017 Asset Purchase Agreement (Agreement),² including, but not limited to, transfer of all utility property, any material change in price, and changes to terms that alter the intent or extent of activities under the Agreement. Any substantive changes shall be submitted for approval in a supplemental application (or other appropriate form) in this docket.
2. Avion will hold existing Avion customers harmless from the results of this Agreement including, but not limited to, the impacts of Avion's transfer of a water right to Creek Development to address Creek Development's non-compliance with Oregon Water Resource Department (OWRD) rules.

¹ The terms of the Agreement provide for closing of the sale no later than ten days after the Buyer obtains OPUC approval. See Agreement at 5.

² Staff received a copy of the executed Agreement on December 6, 2017. However, upon review, Staff found that some of the terms of the executed agreement were slightly different than the terms of the original Asset Purchase Agreement filed with the Commission on November 30, 2017. Staff directed Avion to file the December 6, 2017, Agreement in this docket and has reviewed all new terms of the Agreement and discussed them in this Staff Report.

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3. The final journal entry recording the transaction shall be submitted to the Commission within 60 days after the transaction closes and Creek Development shall provide all books and records necessary for future ratemaking proceedings to Avion.
4. The Commission reserves the right to review for reasonableness all financial aspects of this transaction in future rate proceedings to determine appropriate ratemaking treatment.

Staff has reviewed these conditions with Avion. The Company expressed no objections to the above conditions.

DISCUSSION:

Issue

Whether the Commission should approve the sale of Creek Development and grant the request for waiver of the Commission's 60 day notice requirement.

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 sale of a water utility. ORS 757.485 and OAR 860-036-2120(2) require a public utility doing business in Oregon to obtain Commission approval prior to purchasing the property of another public utility with a value in excess of \$10,000. Given that the seller and the buyer in this docket are both rate-regulated water utilities, ORS 757.480(5) applies to the seller (Creek Development) and ORS 757.485 applies to the buyer (Avion). However, for purposes of review, the standard is the same: the Commission applies the public interest, "no harm" standard.³ Therefore, to gain Commission approval of the proposed transaction, the utilities must demonstrate that *both* Creek Development customers *and* current Avion customers will not be harmed by the proposed transaction.

Further, OAR 860-036-2120(4) provides that the selling water utility (Creek Development) must give its customers and the Commission's Consumer Services Section written notice of the proposed sale 60-days prior to the closing date of the

³ *In re Cline Butte Water, LLC, Application for the Sale, Transfer, or Merger of a Water Utility to SouthWest Water Company*, Docket No. UP 345, Order No. 17-156 at 3-4 (May 1, 2017) ("we apply a 'no harm' standard in approving water utility transfer applications.").

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transaction, and delineates specific items that must be provided in the notice. However, in appropriate circumstances, the Commission may waive any of its Water Division rules for good cause shown.⁴

Analysis

1. The Sale

On November 6, 2017, Avion, the buyer, filed a Notice of Regulated Water Utility Sale, Transfer, or Merger on behalf of Creek Development, the seller, and attached the proposed Asset Purchase Agreement. However, Avion did not submit an Application along with its notice. Therefore, on November 11, 2017, Avion filed an amended application that included Creek Development's Application for Authority to Sell, Transfer, or Merge a Water Utility with the proposed Asset Purchase Agreement attached.⁵

Staff did not think it was necessary for Avion to also file a separate application requesting Commission approval to purchase Creek Development given that Avion provided the information needed for Staff to review the impact of the purchase on Avion customers in the Creek Development Application and the same "public interest" standard applies to both of the rate-regulated water utilities in this transaction. Thus, Staff can evaluate whether the standard is satisfied for both utilities in this single UP docket.

Finally, on December 6, 2017, Avion sent Staff a copy of the executed Asset Purchase Agreement (Agreement)⁶, which provides for closing of the sale not more than 10 days after Commission approval. However, upon review, Staff found that some of the terms in the executed Agreement were slightly different than the terms in the original Asset Purchase Agreement that was filed with the Commission on November 30, 2017. Staff directed Avion to file the December 6, 2017, Agreement in this docket. Staff has since reviewed the new terms of the Agreement and discusses them in this Staff Report.

The Parties

Creek Development is a privately owned rate-regulated water utility serving approximately 155 customers in the vicinity of Sisters, Oregon. The Creek Development system assets include three operational water wells producing 250

⁴ OAR 860-036-0000(3).

⁵ Generally the seller, in this case Creek Development, files the sale application; however, the buyer may also file the sale application on behalf of the seller if necessary.

⁶ In addition to the Asset Purchase Agreement, Staff received an Operating Agreement that was not filed for approval, so Staff makes no recommendation as to whether or not it should be approved; rather, Staff only recommends approval of the utility sale.

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gallons per minute (GPM), 140 GPM, and 40 GPM, and two reservoirs serving 155 customers in a newer subdivision that, with projected growth, will eventually provide water to 300-400 customers.⁷ Avion states that the water system is in excellent condition.

Avion is a privately owned rate-regulated water utility serving approximately 14,000 customers in the vicinity of Bend, Oregon. Avion is a capable water utility that has served as a regent to other water companies, in the past and at present, when Commission involvement has become necessary to provide safe and adequate water service to struggling water companies.

Reason for Sale

Creek Development is a well-kept system; however, the owner who originally built and operated the water system is now deceased. The current owner inherited Creek Development through his father's estate, plans to retire, and has no interest in continuing to operate the water system. Therefore, the current owner of Creek Development has offered to sell the water system to Avion at a very low price. Additionally, currently Creek Development's water system is not in compliance with Oregon Water Resources Department (OWRD) regulations because it lacks the required amount of water mitigation credits. Importantly, Avion's purchase of the Creek Development system will bring Creek Development into compliance with OWRD because Avion states that it has sufficient water rights to serve both its current customers and the new Creek Development customers (in other words, they will remedy Creek Development's OWRD compliance issue).⁸ Over time, water mitigation credits required by OWRD have become very expensive in Central Oregon and this issue is becoming increasingly complex for water companies to navigate.

Compliance with Rule Requirements

Creek Development originally notified its customers of its intent to sell the company on October 18, 2017. However, the contents of the notice that was emailed to customers failed to meet the requirements of OAR 860-036-2120(4) by omitting the effect of the sale on customers and the reason for the sale. Further, the notice also did not meet service requirements, which specify that the notice must be in writing and mailed to customers' last known addresses, unless a customer has previously agreed to service by electronic mail.⁹

⁷ See Avion Response to Staff IR No. 5.

⁸ Avion Response to Staff IR No. 15 ("Avion currently owns enough water rights to serve both Squaw Creek and our current customers.") and No. 18 B ("Avion's water rights transfer will cure the above-referenced lack of water right for the SCC Water System."); see also Avion Response to Staff IR No. 13.

⁹ See OAR 860-036-1010(8).

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Creek Development attempted to remedy the notice deficiencies by sending a second notice by mail on November 3, 2017, to each customer's last known address. This second notice, mailed via U.S. postal service, included all of the components required by Commission rule, including the missing components that were left out in the original notice. However, this second notice provided 58-days-notice prior to the closing of the sale, rather than required 60-days-notice required by rule.¹⁰ As a result, Avion requests that the Commission waive its 60-day notice requirement for good cause.¹¹ Staff reviewed the contents of both notices and believes that customers had adequate notice and opportunity to voice concerns regarding the sale given the 58-day notice. Moreover, technically, many Creek Development customers had additional notice of the sale from the first emailed notice. Therefore, given that the second notice was complete and only two days shy of the 60-day requirement, Staff believes good cause is met to waive the 60-day notice requirement. Additionally, no customer concerns were reported to Consumer Services, except for one question inquiring about water rights.

2. Scope and Terms of the Asset Purchase Agreement

Creek Development will become wholly owned by Avion. The sale is a privately-negotiated, non-auction sale in which the seller transfers all water system assets over to Avion, including easements for the real property on which the water system sits.¹² There are two sets of easements at play in the transaction. First, the Agreement transfers the easements owned by Creek Development over to Avion—these easements provide for access to the water system assets. The water system sale price is \$1, with the buyer assuming the responsibility to provide water to its customers in compliance with Oregon water law. As stated earlier, Creek Development's water system is currently not in compliance with Oregon Water Resources Department (OWRD) regulations.

Second, the Agreement also grants a new easement of approximately five acres over real property that is not owned by Creek Development, but rather is owned by the current owner of Creek Development. This easement will not be transferred with the sale of the water system, but has been determined by Avion to be necessary to provide water service. Thus, as consideration for the new easement onto the seller's land, Avion agreed to the following: one free hookup to the seller, a waiver of the water system development charge to the seller, and a \$1,000 credit toward water charges to the seller.¹³ This easement provides Avion access to two water reservoirs, three active wells, and two reserve wells.

¹⁰ Avion Response to Staff IR No. 1.

¹¹ Avion Response to Staff IR No. 4.

¹² Avion Response to Staff IR No. 12 ("The area currently used by SCC will be granted to Avion in the form of an easement with no ongoing costs.").

¹³ Agreement at 2.

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The terms of the sale do not include any unusual restrictive terms or conditions.

3. Transfer Pricing and Allocation of Gain

Avion states that it will not seek rate recovery for any of Creek Development's existing plant assets, which Avion has proposed to treat as CIAC.¹⁴ Creek Development's net book plant is currently valued at \$198,564.¹⁵ Avion's proposes to add \$32,000 in capital expenditures consisting of \$24,000 in new meters that comport with Avion's system; \$4,000 in legal expenses, and approximately \$4,000 in total for the aforementioned credit to the seller in the free hookup, water credit, and waiver of system development charge. Avion states that the \$24,000 meter replacement is required to replace Creek Development's existing gallon meters with cubic feet meters as Avion's billing system is based on cubic feet meters. Staff makes no recommendation as to the proper ratemaking treatment of these expenditures at this time; rather, they will be reviewed in a future ratemaking proceeding consistent with Staff's proposed Condition 4.

4. Public Interest Compliance

Customers of both Avion and Creek Development will not be harmed by the transaction; rather, both sets of customers are expected to benefit from slightly lower rates as described below.

Creek Development

First, Creek Development customers will likely see an immediate reduction in rates. Staff observes that Creek Development customers' current base rate of \$33.25 should decrease to \$25.97. Creek Development customers' usage rates will also decrease. For example, for Creek Development usage below 12,000 gallons, rates will decline from \$2.75 per 133 cubic feet (or \$2.07 per 100 cubic feet) to \$0.94 per 100 cubic feet. For usage above 12,000 gallons, rates will decline from \$7.69 per 133 cubic feet (or \$5.78 per 100 cubic feet) to \$0.94 per 100 cubic feet.

Second, Creek Development customers will also benefit from the proposed sale to Avion as Avion will be able to provide the Creek Development water system with the necessary water rights to come into compliance with OWRD. Staff views this as a particularly important benefit given that compliance with OWRD is required and is apparently becoming increasingly challenging and expensive for water utilities that do not currently have an adequate supply of water rights or water mitigation credits.

Finally, Creek Development customers should benefit from receiving service from an experienced and highly competent provider. Avion has a long history of successfully

¹⁴ Avion Response to Staff IR No. 21

¹⁵ Avion Response to Staff IR No. 10.

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managing water companies and continues to provide safe, reliable, high-quality service at reasonable rates to its customers.

Avion

Avion customers should see a modest rate decrease as a result of the proposed transaction.

First, Avion estimates that operating expenses associated with serving each Creek Development customer will approximate the costs it currently incurs to serve its customers – approximately \$407 per customer annually¹⁶. Avion has indicated that it will hire no new employees as a result of this transaction because it can serve the new customers with its existing employees.¹⁷ Given that the cost of Avion's existing employees will now be spread across an additional 155 customers that will be added from Creek Development, Avion customers should experience a modest decrease in operating expenses per customer.

Second, as discussed above, Avion has estimated that the transaction will add approximately \$32,000 to its rate base. Avion has indicated that the Creek Development system is in excellent condition and that Avion does not foresee incurring any capital costs, other than the meter replacement, in the near future.¹⁸ The transaction will add approximately \$206 ($\$32,000 / 155$ customers) of rate base per customer. That is significantly lower than the approximately \$1,400 of rate base per customer reflected in the Avion's most recent rate filing – UW 171. As a result, the transaction will cause a modest decrease in rate base per customer.

Therefore, the modest decrease in both operating expenses and rate base per customer is expected to result in rates for Avion's current customers that are lower than they would have been absent the transaction.

5. Records Availability, Audit Provisions and Reporting Requirements

Avion is both rate- and service-regulated by the Commission and will remain so after this sale is final, therefore, Staff should have access to all records necessary to review expenses related to this property sale in Avion's next rate case. Additionally, Staff's proposed Condition 3 ensures that the final journal entries are submitted to the Commission within 60 days of closing and also requires Creek Development to provide certain records necessary for ratemaking to Avion. Further, Condition 4 clarifies that all ratemaking decisions will be made in a future rate case.

¹⁶ Avion Response to Staff IR No. 6

¹⁷ Avion Response to Staff IR No. 11.

¹⁸ Avion Response to Staff IR No. 7.

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Conclusion

Staff concludes that the sale of Creek Development to Avion meets the public interest standard and recommends that Creek Development's Application be approved subject to Staff Conditions 1 through 4. Staff also recommends that the Commission grant the request to waive the 60-day notice requirement for good cause shown.

PROPOSED COMMISSION MOTION:

Approve the sale of Creek Development to Avion, subject to Staff's proposed Conditions 1-4, and grant the company's request for waiver of the 60-day notice period for good cause shown.

CreekDevelopment.UP 358

Avion Water Company, Inc.

UP 358, IR 01-14

1. Please confirm the date the customer notice (dated 11-3-2017 and filed in docket no. UP 358) was mailed via U.S. Postal service to all Squaw Creek Canyon Development (Squaw Creek) customers.

Yes, I am confirming that the customer notice dated 11-3-17 was mailed via U.S. Postal Service and to all Squaw Creek Canyon.

Avion Water Company, Inc.
UP 358, IR 01-14

4. Given that the official notice mailed to customers does not appear to comply with the necessary 60day notification of customers provided by OAR 860-036-212-(4) (the sale is set to close in less than 60 days of the notice), is Avion requesting a waiver of the 60-day notice requirement?

Yes. Emails and notices on doors were posted in early October. It was my mistake that caused the U.S. Mail notices to go out late.

Avion Water Company, Inc.
UP 358, IR 01-14

5. Please describe the Squaw Creek Canyon Development Water Utility System in detail, including the number of wells included, major system infrastructure and system components, water storage facilities, the capacity of the water system and the number of customers served.

There are 2 reservoirs with a total capacity of 120,000 and 3 operational wells producing 250gpm, 140gpm, and 40gpm. The current customer base is 155. The potential customer base may eventually total 300-400 customers depending on when and how the properties around the subdivision develop and changes to land use laws. The maximum system capacity is also dependent on type of users that connect in the future, i.e. large demand, low demand, etc.

Avion Water Company, Inc.
UP 358, IR 01-14

6. Please provide detailed estimates of the costs Avion expects to incur upon purchase of Squaw Creek, including but not limited to, an estimate of all administrative and operational costs and capital costs incurred by Avion as a result of the purchase of the Squaw Creek Water System.

The operational and administrative costs expected are to be roughly \$407 per customer annually. This includes operational and administrative costs for normal operating once the transaction is complete. This was obtained by using Avion's current estimated 2017 operational costs divided by number of customers. We do expect an eventual investment of \$24,000 to replace the gallon meters with cubic feet meters.

Transactional costs are estimated to be \$4000 in attorney's fees.

We also expect \$5,000 in cost to transfer a water right to the system.

The total estimated rate base invested per SCC customer will be $(\$24,000 + 4,000 + 5,000) / 155 + \$407 = \$620$ per customer. Current rate base per customer of Avion is $\$19593147 / 14,000 = \1400 per Avion customer. Combining the two will lower the rate base per customer, not by much, but it will lower it.

Avion Water Company, Inc.
UP 358, IR 01-14

7. Please provide an estimate of the additional ongoing operating and capital costs Avion expects to incur as a result of the purchase.

See Question No. 6 for operational costs. I do not foresee any ongoing capital costs.

Avion Water Company, Inc.
UP 358, IR 01-14

10. Please provide calculations showing the current net book value of Squaw Creek Water System.

Net book value of Squaw Creek was estimated at \$198,564 (net undepreciated plant). This information was gathered from SCC's annual report which the PUC is in possession of and can check the net book value of the system.

Avion Water Company, Inc.

UP 358, IR 01-14

11. Does Avion plan to employ any of the current employees of Squaw Creek Water System or to hire additional employees as a result of this transaction?

No.

Avion Water Company, Inc.

UP 358, IR 01-14

12. The purchase agreement includes a lease for real property used for the water system; does Avion expect to continue this lease? Please provide the annual cost Avion will incur for the property lease and whether the lease is connected to any property necessary to operate the water system, i.e. well.

No, there will be no lease in the final agreement. The area currently used by SCC will be granted to Avion in the form of an easement with no ongoing costs.

15. Regarding the water rights currently owned by Avion, please answer the following:
- A. Please confirm that Avion currently owns enough water rights to serve its current Avion customers, even in a dry year, as well as the Squaw Creek Water System customers, even in a dry year.
 - B. Please confirm that, and explain why, Avion's provision of the water rights necessary to serve the Squaw Creek Water System customers will not result in additional cost—either currently or in the future—to serve Avion's current customers?

AVION WATER COMPANY RESPONSES

Regarding Avion Water Rights

- A. Avion currently owns enough water rights to serve both Squaw Creek and our current customers. A dry year is generally used in reference to surface water rights, not groundwater rights. As all of Avion's water rights are groundwater rights a "dry year" does not affect Avion. Since the basin in which Avion withdraws water from is estimated to recharge at 2500cfs it is unlikely that Avion will be under watering restrictions due to a lack of water. A good source of information on the Deschutes basin aquifer is in Marshall Gannet's reports for USGS.
- B. Avion will not speculate on the future costs unless the PUC can provide all relative law changes and weather patterns for the future in question. A brief discussion of water rights below roughly explains how we can add a new point of appropriation for SCC;

When Avion consolidated all our small permits into one large (permit 12788) it did not allow any of the small water rights to be used alone; i.e. all had to be assigned to the same points of appropriation and all the points had to be connected. However, upon further inspection it turns out we can use several of the small rights separate from the ones contained under 12788 without lowering the total volume available under 12788. This allows us to add extra points of appropriation and use more water without detracting from our existing supply.

18. Section 4.7 Compliance with Laws of the Asset Purchase Agreement states, in part:

"Except for the water mitigation requested by the OWRD, Seller is not in violation of any applicable laws or regulations..."

- A. Please describe Squaw Creek Development's violations of laws and/or administrative rules regarding OWRD.
- B. Please confirm that the water rights transfer described in Avion's response to Information Requests 6 and 13 will cure Squaw Creek Water System's currently outstanding violations.
- C. Company Response:

AVION WATER COMPANY RESPONSES

Section 4.7 – Compliance with Laws

- A. *Seller does not currently have a water right assigned to the operation of the SCC Water System.*
- B. *Avion's water rights transfer will cure the above-referenced lack of water right for the SCC Water System.*

Avion Water Company, Inc.

UP 358

IR 21. Regarding the accounting for the net book value of the Creek Development properties to be acquired, please confirm that in addition to recording the net book value of the assets acquired, Avion will record an amount in Account 271 Contributions in Aid of Construction (CIAC) equal to the net book value of the assets acquired at closing. Please also confirm that, in combination, the aforementioned entries will have no impact on Avion's rate base (i.e., that the net book value will be offset by the value recorded in CIAC).

Yes, the combination of entries will have no impact on Avion's rate base.