

AFFILIATED INTEREST CONTRACT APPLICATION

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Date: June 5, 2018

COMPANY NAME: Oregon Water Utilities – Cline Butte, Inc.

ADDRESS: 1230 Golden Pheasant Dr.

CITY, STATE, ZIP: Redmond, OR 97756

Oregon Public Utility Commission
Filing Center
PO Box 1088
Salem, OR 97308-1088

RE: Oregon Water Utilities – Cline Butte, Inc. Application for an Affiliated Interest Agreement with **SouthWest Water Company**, including its subsidiaries, Suburban Water Systems, Northwest Utility Systems, Oregon Water Utilities-Mountain Lakes, Inc., and Oregon Water Utilities, Inc., pursuant to ORS 757.495 and OAR 860-036-2210

This affiliated interest application is submitted in the manner and form indicated by OAR 860-036-2210.

Background

Oregon Water Utilities-Cline Butte, Inc. ("OWU-CB") has operated using shared services under management agreements since at least 2002, when it was granted an exclusive service territory by the Oregon Public Utility Commission ("Commission").¹ Its original management service agreement with then-owner Eagle Crest, Inc. was approved by the Commission in Order No. 02-581, and included the following services: customer communications, management, finance, accounting and tax, legal and regulatory, office services, purchasing services, risk management, information systems support, corporate services, and miscellaneous service expenses. Costs were charged to OWU-CB through direct charge at full cost, including salary, salary-related expenses, out-of-pocket travel expenses, and direct materials and supplies.² OWU-CB has subsequently reported to the Commission in its annual Affiliated Interest Report the costs incurred under its management service agreement with subsequent owner Oregon Resorts, LLC.³ With this application, OWU-CB requests Commission approval to obtain shared services under a Management and Operations Agreement ("Agreement").

With regard to the 2002 management agreement, per Commission Order No. 02-581, "the annual charge for provisions hereunder is approximately \$69,000." The 2002 utility statistics

¹ See Commission Order No. 02-849.

² See Commission Order No. 02-581.

³ See Commission Docket No. RW 55.

book published by the Commission reports 538 total customers for OWU-CB, which would result in a monthly expense per customer of approximately \$10.69. As heretofore described, management agreements allow for companies, and customers, to take advantage of economies of scale. Given the 1,693 OWU-CB connections reported in the 2016 utility statistics book published by the Commission, the proposed cost of management services rendered by SouthWest Water Company ("SouthWest") and Suburban Water Systems ("Suburban") for OWU-CB of \$125,300 would result in a monthly cost per customer of only \$6.17, a decrease of over 42 percent from the previous management agreement approved by the Commission.

The Commission has historically stated in orders approving affiliate interest agreements that it need not determine the reasonableness of all financial aspects of the agreement for ratemaking purposes in approving the affiliate interest agreement, but reserves that issue for subsequent proceedings (ie. general rate cases).

INFORMATION REQUIREMENTS

(a) The applicant's exact name and the address of its principal business office;

Oregon Water Utilities – Cline Butte, Inc.
1230 Golden Pheasant Dr.
Redmond, OR 97756

(b) The name and address of the person authorized on the water utility's behalf, to receive notices, inquiries, and communications regarding the information;

Bob Kelly, CMA, CPA
Vice President Regulatory Affairs
SouthWest Water Company
1325 N. Grand Avenue, Suite 100
Covina, CA 91724
(626) 543-2590
Bkelly@swwc.com

(c) A statement describing the relationship between the water utility and the contracting entity as defined by ORS 757.015 and 757.490;

Please refer to Exhibit D to this application for an ownership chart of OWU-CB and its affiliates.

OWU-CB is a wholly-owned subsidiary of Northwest Utility Systems ("NWUS"), which is a wholly-owned subsidiary of SouthWest Water Company. Oregon Water Utilities, Inc. ("OWU") and Oregon Water Utilities-Mountain Lakes, Inc. ("OWU-ML") are wholly-owned subsidiaries of NWUS. Suburban is a wholly-owned subsidiary of SouthWest and has no ownership in NWUS. For purposes of this Application, OWU, OWU-CB, and OWU-ML may each be individually referred to as a "Purchaser" and collectively as the "Purchasers." Additionally, SouthWest, Suburban, and NWUS may each be referred to as a "Provider" and collectively as the "Providers." The Providers and Purchasers may be referred to collectively as the "Parties."

ORS 757.015(2) defines "Affiliated interest" as every corporation and person in any chain of successive ownership of five percent or more of the voting securities of such public utility. ORS 757.015(3) defines "Affiliated interest" as every corporation five percent or more of whose voting securities are owned by any person or corporation owning five percent or more of the voting securities of such public utility or by any person or corporation in any chain of successive ownership of five percent or more of voting securities of such public utility.

Per ORS 757.015(2) and (3), the relationship between OWU-CB and each of the following entities qualify as affiliated interests:

- SouthWest, and its subsidiaries;
- Suburban
- NWUS;
- OWU; and
- OWU-ML.

(d) The amount, kind, and ratio to total voting securities held, if applicable;

SouthWest's subsidiaries have no ownership in OWU-CB.

(e) A list of all officers and directors of the affiliated interest who are also officers or directors of the applicant;

The following are the officers and directors of SouthWest, Suburban, NWUS, OWU-ML, OWU, and OWU-CB:

- President and CEO – Michael Quinn
- CFO and Treasurer & Director – Kirk Michael
- Vice President, General Counsel & Secretary and Director – William Dix

(f) The pecuniary interest, directly or indirectly, of any officer or director who is a party to the contract;

None.

(g) A description of the goods or services to be provided, the cost incurred in providing each of the goods or services, the market value of the goods or services if different from the costs, and the method or methods proposed for pricing those goods or services;

Services and Goods

OWU-CB will receive services and goods from the Providers in accordance with the Agreement, which is attached to this Application as Exhibit A. The Agreement establishes the terms and conditions under which services and goods may be provided by the Providers to OWU-CB.

Per the agreement, the Providers may render services for OWU-CB, including the following:

- 1. FINANCIAL AND BANKING:** Provide general oversight for all financial activities, as well as cash management, reporting, and monitoring. Prepare financial and government reports for the Purchasers, administer and coordinate audits, and maintain relationships with banks for line of credit financing and daily banking/cash management functions.
- 2. HUMAN RESOURCES:** Provide guidance and support for human resources and payroll policies, practices, and programs. Assist Purchasers to comply with new and existing employee legal requirements, including current developments in Americans with Disabilities Act, EEOC, sexual harassment, etc. Administer employee benefit and pension plans.

- 3. INSURANCE & RISK MANAGEMENT:** Maintain relationship with risk manager and administer liability and insurance programs and associated employee benefit plans.
- 4. LEGAL:** Maintain relationships with outside counsel, coordinate legal activity, review proposed contracts, leases, and agreements, and assist Purchasers to comply with applicable federal and state regulations and laws.
- 5. RATES AND REGULATION:** Prepare and file reports and applications with the appropriate regulatory bodies, including the Commission, maintain and update tariffs as necessary, and assist Purchasers to comply with applicable regulations.
- 6. COMMUNICATIONS:** Assist Purchasers with the preparation of communication materials (including press releases, brochures, audio visual presentations, and speeches), plant tours, public exhibits and displays, and other related services to inform employees, customers, government agencies, and the general public.
- 7. ENGINEERING:** Assist the Purchasers with planning, designing, inspecting, and constructing facilities, periodically inspecting the Purchasers' structures and equipment, and assisting in the evaluation of new and existing products and procedures.
- 8. ACCOUNTING AND BOOKKEEPING:** Provide accounting and bookkeeping services, including the preparation of financial reports, tax returns and budgets, maintain appropriate records, process service orders, and ensure accounting methods and procedures conform to applicable governmental requirements, rules, and regulations.
- 9. INFORMATION SYSTEMS:** Provide electronic data processing services, including customer billing and accounting, and assist Purchasers with preparation of reports, including those required by Federal and State agencies.
- 10. ADMINISTRATION:** Perform corporate activities and keep Purchasers informed on aspects of economic, regulatory, governmental, and operational developments and conditions that may affect the Purchasers.
- 11. OPERATIONS AND MAINTENANCE:** Perform services related to the operation and maintenance of the utilities, including operations and maintenance functions and other tasks necessary to maintain safe and reliable utility services.

Per the Agreement, the Providers may also render goods for OWU-CB, including:

- 1. OFFICE AND SHOP SPACE;**
- 2. VEHICLES AND TRANSPORTATION EQUIPMENT;**
- 3. TOOLS;**
- 4. COMPUTERS, TELEPHONE, INTERNET, AND OTHER COMMUNICATIONS AND IT EQUIPMENT;**
- 5. OFFICE FURNITURE, SUPPLIES, AND OTHER MISCELLANEOUS EQUIPMENT.**

Pricing Goods and Services

As stated in the Agreement, OWU-CB may incur two types of costs, direct or common. Direct costs are those costs incurred for services rendered by any of the Providers for OWU-CB that are attributable specifically to OWU-CB. It is anticipated that direct costs will be incurred primarily from services rendered by NWUS, but also for certain services rendered by Suburban.

OWU-CB will not employ its own personnel, but will rely on shared services rendered by the Providers. Specifically, employees of NWUS will perform day-to-day operations for OWU-CB. NWUS currently allocates employee time directly to OWU-CB, OWU-ML, or OWU using time cards. For costs that are not attributable to a specific entity (eg. employee safety training or vehicle maintenance), costs are currently allocated amongst the benefitting entities using meter equivalent factors applied to prior year end active connections. Meter equivalent factors is a reasonable, straight-forward, and common allocation methodology and is based on the standard published by the American Water Works Association (“AWWA”), as shown in the figure below:

Meter Size	Meter Equivalent factor based on 5/8"
5/8 inch	1.00
3/4 inch	1.50
1 inch	2.50
1-1/2 inch	5.00
2 inch	8.00
3 inch	15.00
4 inch	25.00
6 inch	50.00
8 inch	80.00

Source: AWWA

Services for OWU-CB may also be rendered by Suburban, a subsidiary of SouthWest located in California. Similar to the services and goods rendered for OWU-CB by NWUS, the cost of any services or goods rendered by Suburban for OWU-CB that are directly attributable to OWU-CB are currently charged to OWU-CB directly. Costs of services provided by Suburban to OWU-CB that benefit OWU-CB and at least one of the other Purchasers are currently allocated between those Purchasers benefitting from those services. For example, the cost of a manager employed by Suburban to provide a safety training to all employees of NWUS is allocated between the three Purchasers based on meter equivalent factors. Services rendered by Suburban include managerial and administrative functions, including IT, accounting, customer service, human resources, and general management.

Services rendered by SouthWest for OWU-CB include functions such as finance, regulatory, and executive leadership. SouthWest currently does not render services directly for OWU-CB; all services rendered by SouthWest for OWU-CB are allocated between the benefitting entities using a three factor formula consisting of gross plant, payroll, and operating expenses. This three factor formula is currently used by SouthWest to allocate corporate overhead costs between its subsidiaries and has been determined to be a reasonable cost allocation methodology that allows SouthWest to maintain consistency of corporate overhead cost recovery across its subsidiaries.⁴

⁴ This 3-factor allocation methodology is used by Suburban and was agreed to by Office of Rate Payer Advocates (ORA) in Suburban’s current general rate case (A. 17-01-001). Calculations are in general accordance with the methodology described in the California Public Utilities Commission’s (“CPUC”) July 26, 1956, four-factor

The cost allocation methodology currently used for goods and services rendered by the Providers to OWU-CB is consistent with the Guidelines for Cost Allocations and Affiliate Transactions published by the National Association of Regulatory Utility Commissioners (“NARUC”), which is included with this Application as Exhibit C. The current cost allocation methodology is summarized in the following table:

Provider	Service Type	Cost Type	Allocation Methodology
NWUS	Operations	Direct Costs	Direct
NWUS	Operations	Common Costs	Meter Equivalent Factors applied to Year End Active Connections
Suburban	Administrative	Direct Costs	Direct
Suburban	Administrative	Common Costs	Meter Equivalent Factors applied to Year End Active Connections
SouthWest	Administrative	Common Costs	3 Factor (Gross Plant, Payroll, Operating Expenses)

Goods and services are rendered by the Providers for OWU-CB at cost, without any profit markup. Goods and services are rendered at cost and subject to review by the Commission during general rate cases.

(h) An estimate of the amount the water utility will pay annually for the goods or services and the accounts in which it will record the charges;

An estimate of annual costs of administrative services to be incurred by OWU-CB in 2018 from the Providers, by functional category, is shown below:

Function*	2018 Cost Estimate
Executive Management**	\$48,887
Legal	\$1,393
HR	\$9,290
Facilities	\$4,057
Finance	\$31,634
IT	\$32,229
Regulatory	\$2,205
Total	\$129,696

*Functions listed are those requested by Staff in Request for Information No. 18, Docket No. UP 345.

**This function also includes customer service.

However, Condition 11 of the stipulation approved by Order No. 17-156, approving the sale of OWU-CB to SouthWest, states that OWU-CB will not seek rate recovery of more than \$125,300 annually for affiliated interest costs charged by SouthWest and Suburban in the first general rate case or similar proceeding filed by OWU-CB following the acquisition.

procedure “Allocation of Administrative and General Expenses and Common Utility Plant”. By “generally in accordance” we mean that the CPUC deviated from the 1956 methodology by excluding the fourth factor of the 1956 methodology, connections, and added a plant factor for non-owned systems.

The costs of shared services will be recorded by OWU-CB according to the Uniform System of Accounts for Class A Water Utilities, published in 1996 by the National Association of Regulatory Utility Commissioners.

(i) The reasons, in detail, relied upon by the water utility for procuring the proposed goods or services from the affiliate and benefits, if any, utility customers and the general public will derive from the provision of goods or services.

Customers benefit from the quality and diversification of services rendered by the Providers to OWU-CB that would not be possible to obtain on a comparable economic basis elsewhere. It is common for shared services and management agreements to be employed by water utilities, as well as in other industries, because obtaining shared services allows the utility to take advantage of economies of scale, thereby benefitting customers through cost savings as well as increased quality and diversification of services. The Commission has approved many such agreements in both the water and energy industries.⁵

(j) A description of the procurement process and the reasons, in pertinent detail appropriate to the complexity of the procurement, relied upon by the water utility for procuring the proposed goods or services without a competitive procurement process, if such a process is not used.

As described above, absent the Agreement, OWU-CB would be required to hire additional employees to independently provide the services. SouthWest performed a study to determine the cost amount of compensating full-time employees for OWU-CB based on the local market. The study is attached to this application as Exhibit B. Below is a summary of the results:

Job Title	Average Annual Base Salary*
Full Charge Bookkeeper/Accounting Manager	\$51,634
Human Resource Manager	\$93,376
Information Technology Manager	\$72,572
Customer Service Manager	\$73,940
Regulatory Affairs Manager	\$97,266
General Manager/CEO	\$112,828
TOTAL	\$501,616

*Note that data provided is for base salary only and doesn't include loaded costs such as medical benefits, incentive compensation, insurance, taxes, retirement plans or other direct and indirect costs.

As shown in the summary above, hiring a full-time general manager alone would cost OWU-CB well over \$100,000 for base salary alone, and would not include the additional services to be provided by SouthWest and Suburban, including Information Technology, Human Resources, Accounting, Regulatory, and Customer Service. Under this shared services arrangement, OWU-CB will incur much lower costs than it would otherwise if it were to hire local employees at local market rates.

(k) Transfer prices in contracts or agreements for the procurement of goods or services under competitive procurement shall be presumed to be the market value, subject to evaluation of the procurement process;

⁵ See Commission Orders No. 17-316, No. 16-452, No. 16-101, etc.

OWU-CB requests waiver of the transfer pricing rule because operating under the Agreement results in economies of scale that benefit customers.

OAR 860-036-2230 (2)(e) states “When services or supplies are sold to a water utility by an affiliate, sales must be recorded in the water utility's accounts at the affiliate's cost or the market rate, whichever is lower. The affiliate's cost must be calculated using the water utility's most recently authorized rate of return.”

The Commission has waived the affiliate transaction pricing rules in previous dockets of both water and energy utility companies. For example, in Order No. 16-345, the Commission approved Staff's recommendation to waive the higher of cost or market rule for an energy utility as it was determined that the transaction was “fair and reasonable and not contrary to the public interest.” In Order No. 17-169, the Commission approved Staff's recommendation to waive the lower of cost or market rule because the transaction was “both cost effective and necessary.” In Order No. 16-121, The Commission approved Staff's recommendation to waive the lower of cost or market rule because the transaction was “cost effective and time effective.” In Order No. 16-009, the Commission approved Staff's recommendation to waive the lower of cost or market rule because “the negotiated agreement ‘contemplates economies of scale’ likely to result in lower costs for the Company and, therefore, lower rates for consumers.” Finally, in Order No. 16-101, the Commission approved a water utility's application for a master services agreement because “the Companies will benefit from economies of scale because the Affiliate's cost of service is spread across a larger customer base.” Clearly, the Commission is amenable to waiving the transfer pricing rules when doing so results in economies of scale and/or is not contrary to the public interest.

Economies of scale are achieved through the efficient use of resources in serving both water and wastewater customers. These lower costs are passed on to the customer through lower rates, as established in a general rate case.

Absent the approval of the Agreement, OWU-CB would be required to acquire those goods and services either through purchases and hiring additional employees or through external contract labor and products. Operating under a management contract allows OWU-CB to have access to specialized resources. For this reason, the Commission should waive the lower of cost or market rule, thereby allowing customers to benefit from the economies of scale created by the Agreement.

The services that will be provided to OWU-CB by SouthWest and/or Suburban will be charged at cost; that is, they represent the actual costs incurred by SouthWest and/or Suburban in providing the services and not a “for-profit” rate. The shared services provided will result in shared costs that provide efficiency and cost competitiveness in local markets.

ATTACHMENTS

(l) A copy of the proposed contract or agreement between the water utility and the contracting entity; and

A copy of the Agreement is included as Exhibit A.

(m) Copies of all resolutions of directors authorizing the proposed transactions and, if stockholders' approval has been obtained, copies of the resolutions approved by the stockholders.

Not applicable. No resolutions or stockholder approval was necessary.

For the reasons set forth above, OWU-CB respectfully requests that the Commission issue an order approving the Agreement pursuant to the provisions of ORS 757.495 and OAR 860-0386-2210.

DATE: June 5, 2018

NAME OF COMPANY: Oregon Water Utilities – Cline Butte, Inc.

Robert Kelly
(SIGNATURE OF AUTHORIZED PERSON)

ROBERT KELLY
(PLEASE PRINT NAME)

Vice President Regulatory Affairs
(TITLE) South West Water Company

Exhibit A

MANAGEMENT AND OPERATIONS AGREEMENT

MANAGEMENT AND OPERATIONS AGREEMENT

This Management and Operations Agreement (“Agreement”) is made by and between SouthWest Water Company, Inc., (“SouthWest”), Suburban Water Systems (“Suburban”), Northwest Utility Systems (“NWUS”), Oregon Water Utilities, Inc. (“OWU”), Oregon Water Utilities – Cline Butte, Inc. (“OWU-CB”), and Oregon Water Utilities – Mountain Lakes, Inc. (“OWU-ML”) to be effective as of June 2, 2017. For purposes of this Agreement, OWU, OWU-CB, and OWU-ML may each be individually referred to as a “Purchaser” and collectively as the “Purchasers.” Additionally, SouthWest, Suburban, and NWUS may each be referred to as a “Provider” and collectively as the “Providers.” The Providers and Purchasers may be referred to collectively as the “Parties.” SouthWest is the entity that owns, or has substantial operational control of, the Purchasers and includes SouthWest’s affiliates. “Affiliates” means any entity that is controlled, directly or indirectly, by SouthWest.

I. RECITALS

Whereas, SouthWest business units operate in the water and wastewater services industry, and the Purchasers are water or wastewater utilities providing service in the State of Oregon and are wholly owned subsidiaries of NWUS, which is a wholly owned subsidiary of SouthWest;

Whereas, SouthWest's officers and employees are familiar with and experienced in all facets of the water and wastewater utility business and are qualified to aid, assist, and advise the Purchasers in their business operations;

Whereas, as a result of certain economies of scale and SouthWest’s experience and expertise, SouthWest is able to provide a range of management and operations services relating to the Purchasers’ businesses, and each of the Purchasers wishes to obtain these management and operations services from SouthWest;

Whereas, SouthWest provides to its other water and wastewater subsidiaries services similar to those provided to the Purchasers;

Whereas, the Purchasers cannot obtain superior quality and diversification of services on a comparable economic basis elsewhere; and

Whereas, OWU-CB and OWU-ML are water utilities regulated for rates and service by the Oregon Public Utility Commission (“Commission”) and subject to Commission rules and regulations regarding affiliate interests;

Now, therefore, in consideration of the mutual covenants hereinafter contained, the Parties agree as follows:

II. SERVICES

- A. SouthWest shall make qualified employees available to perform or assist in the performance of services to be rendered for the Purchasers by the Providers under this agreement.
- B. The services to be provided by the Providers to the Purchasers include, but are not limited to, the following:

- 1. FINANCIAL AND BANKING:** Provide general oversight for all financial activities, as well as cash management, reporting, and monitoring. Prepare financial and government reports for the Purchasers, administer and coordinate audits, and maintain relationships with banks for line of credit financing and daily banking/cash management functions.
- 2. HUMAN RESOURCES:** Provide guidance and support for human resources and payroll policies, practices, and programs. Assist Purchasers to comply with new and existing employee legal requirements, including current developments in Americans with Disabilities Act, Equal Employment Opportunity Council, sexual harassment, etc. Administer employee benefit and pension plans.
- 3. INSURANCE & RISK MANAGEMENT:** Maintain relationship with risk manager, and administer liability and insurance programs and associated employee benefit plans.
- 4. LEGAL:** Maintain relationships with outside counsel, coordinate legal activity, review proposed contracts, leases, and agreements, and assist Purchasers to comply with applicable federal and state regulations and laws.
- 5. RATES AND REGULATION:** Prepare and file reports and applications with the appropriate regulatory bodies, including the Commission, maintain and update tariffs as necessary, and assist Purchasers to comply with applicable regulations.
- 6. COMMUNICATIONS:** Assist Purchasers with the preparation of communication materials (including press releases, brochures, audio visual presentations, and speeches), plant tours, public exhibits and displays, and other related services to inform employees, customers, government agencies, and the general public.
- 7. ENGINEERING:** Assist the Purchasers with planning, designing, inspecting, and constructing facilities, periodically inspecting the Purchasers' structures and equipment, and assisting in the evaluation of new and existing products and procedures.
- 8. ACCOUNTING AND BOOKKEEPING:** Provide accounting and bookkeeping services, including the preparation of financial reports, tax returns and budgets, maintain appropriate records, process service orders, and ensure accounting methods and procedures conform to applicable governmental requirements, rules, and regulations.
- 9. INFORMATION SYSTEMS:** Provide electronic data processing services, including customer billing and accounting, and assist Purchasers with preparation of reports, including those required by federal and state agencies.
- 10. ADMINISTRATION:** Perform corporate activities and keep Purchasers informed on aspects of economic, regulatory, governmental, and operational developments and conditions that may affect the Purchasers.
- 11. OPERATIONS AND MAINTENANCE:** Perform services related to the operation and maintenance of the utilities, including operations and maintenance functions and other tasks necessary to maintain safe and reliable utility services.

III. GOODS

- A. Certain goods shall be made available for the Purchasers by the Providers under this Agreement.
- B. The shared goods to be provided include, but are not limited to, the following:
 - 1. OFFICE AND SHOP SPACE;**
 - 2. VEHICLES AND TRANSPORTATION EQUIPMENT;**
 - 3. TOOLS;**
 - 4. COMPUTERS, TELEPHONE, INTERNET, AND OTHER COMMUNICATIONS AND IT EQUIPMENT;**
 - 5. OFFICE FURNITURE, SUPPLIES, AND OTHER MISCELLANEOUS EQUIPMENT.**

IV. PRICING GOODS AND SERVICES

- A. Services and goods shall be rendered by the Providers for the Purchasers at cost, without any profit markup. Services and goods are rendered at cost and subject to review by the Commission during general rate cases.
- B. The following costs may be incurred by the Purchasers for services rendered by the Providers:
 - 1. Direct Costs - Costs incurred for services rendered by any of the Providers for the Purchasers that are attributable to a specific Purchaser are assigned directly to that entity. For example, an employee of NWUS may record his time directly to OWU-CB for work performed repairing a water distribution pipe. Similarly, the cost of goods used in the repair of the pipe would be charged directly OWU-CB.
 - 2. Common Costs – Costs incurred for services rendered by any of the Providers for the Purchasers that are not attributable to a specific Purchaser shall be allocated amongst the entities benefitting from those services using the primary cost driver of the common costs, or a relevant proxy in the absence of a primary cost driver, to allocate costs between regulated and non-regulated services or products. For common costs allocable from SouthWest, a three factor allocation methodology calculated using equally weighted gross plant, payroll, and operating expenses is currently used in order to maintain consistency across SouthWest’s business units. For common costs allocable from Suburban and NWUS, meter equivalent factors calculated using end of prior year active connections is currently being used. Meter equivalent factors is a reasonable, straight-forward, and common allocation methodology and is based on the standard published by the American Water Works Association.

V. PAYMENT FOR GOODS AND SERVICES

- A. In consideration for the services and goods to be rendered by the Providers for the Purchasers as hereinbefore provided, the cost thereof will be accrued and allocated to the Purchasers in the period the goods and services are performed.

VI. COMPENSATION AND EMPLOYMENT

Regarding employees of the Providers providing services to the Purchasers:

- A. The Providers will pay all wages, bonuses, and other compensation and provide employee benefits and will sponsor all employee benefit plans, including healthcare and 401(k) plans.
- B. The Providers shall have authority over all decisions with respect to hiring, employing, setting the terms and conditions of employment, compensating, terminating, recruiting, interviewing, selecting, hiring, training, reprimanding, directing, controlling, and supervising.
- C. The Providers will employ their services and these are not, and will not be deemed to be, employees of the Purchasers, and are subject to the Providers' rules, policies, and procedures regarding employment.
- D. The Providers will comply with all applicable federal, state, and local laws applicable to them regarding compensation, hours of work, and other terms and conditions of employment. The Providers will be solely responsible for all contributions, taxes, withholdings, assessments, and reporting obligations under all applicable federal, state, and local laws, including, without limitation, federal, state, and local income taxes, Social Security and Medicare taxes, payment of workers' compensation, disability benefit insurance, and unemployment insurance.

VII. FORCE MAJEURE

- A. The Providers will not be responsible for the failure or delay in the performance of any particular service if caused by an act of God (including but not limited to fire, flood, hurricane, earthquake, drought, explosion, and unusually severe weather), acts or threats of terrorism, act of public enemy, war, hostilities, invasion, government acts or regulations, embargo, quarantine, epidemic, labor stoppages beyond its reasonable control, accident, or cause similar or dissimilar to the foregoing beyond its control. If any of the Providers is rendered wholly or partially unable to carry out its obligations under this Agreement as a result of an event of Force Majeure, then its obligations pursuant to this Agreement will be suspended only during the continuance of such Force Majeure event, and for no longer period. Upon the commencement of such Force Majeure event, the Provider will notify the Purchasers and will resume performance of its obligations as soon as practicable.

VIII. CONFIDENTIALITY

- A. The Parties acknowledge and agree that certain non-public information supplied by each to the others during the term of this Agreement may be proprietary or confidential. All such non-public information shall be received in confidence and kept confidential (unless otherwise required by applicable law and consistent with the Commission's mandate to ensure safe, reliable and high quality service at fair, just, reasonable and sufficient rates).

IX. TERM OF AGREEMENT

- A. This Agreement shall be retroactively effective as of June 2, 2017.

- B. This Agreement shall be the sole agreement by and between the Parties concerning the subject matter hereof and shall supersede all such prior agreements, written or oral.
- C. This Agreement shall continue in force and effect until terminated by any of the Parties hereto giving the other Parties ninety (90) days notice in writing. Alternatively, if a Purchaser ceases to be an affiliate of SouthWest, then this Agreement shall be terminated automatically with respect to such Company at such time without further action.

X. AMENDMENTS

- A. This Agreement may not be amended except in writing signed by SouthWest and any of the other Parties to which the amendment applies.
- B. Notwithstanding Section X(A), from time to time, SouthWest may amend this Agreement without the consent of the other Parties in order to join an affiliate as a party to this Agreement. In such event, any such affiliate so joined shall be a "Purchaser" for all purposes of the Agreement.

IN WITNESS WHEREOF, the Parties have caused this agreement to be signed in their respective corporate names by their respective duly authorized officers as of the date first above written:

SOUTHWEST WATER COMPANY

By Michael O. Quinn

Date 6/5/2018

Name MICHAEL O. QUINN

Title CEO

OREGON WATER UTILITIES, INC.

By KB Michael

Date 6/5/2018

Name KIRK B. MICHAEL

Title CFO

SUBURBAN WATER SYSTEMS

By Michael O. Quinn

Date 6/5/2018

Name MICHAEL O. QUINN

Title CEO

OREGON WATER UTILITIES – CLINE BUTTE, INC.

By KB Michael

Date 6/5/2018

Name KIRK B. MICHAEL

Title CFO

NORTHWEST UTILITY SYSTEMS

By Michael O. Quinn

Date 6/5/2018

Name MICHAEL O. QUINN

Title CEO

OREGON WATER UTILITIES – MOUNTAIN LAKES, INC.

By KB Michael

Date 6/5/2018

Name KIRK B. MICHAEL

Title CFO

Exhibit B

COMPARABLE BASE SALARY DATA

Exhibit B

Annual Base Salary Data for Redmond, Oregon

Job Title	Matching Occupation	Market (Redmond, OR)	
		Average Annual	Source*
Full Charge Bookkeeper/Accounting Manager	Bookkeeping Manager	\$51,634.00	ERI
Human Resource Manager	Human Resources Manager	\$93,376.00	ERI
Information Technology Manager	IT Manager	\$72,572.00	ERI
Customer Service Manager	Customer Service Manager	\$73,940.00	ERI
Regulatory Affairs Manager	Regulatory Affairs Manager	\$97,266.00	ERI
General Manager/CEO	CEO	\$112,828.00	ERI

*Data obtained from the Economic Research Institute Salary Benchmarking Data

2017 Oregon Wage Information for Oregon Statewide

SOC Code	Occupational Title	2017 Annual Mean	Source**
11-1021	General and Operations Managers	\$104,808.00	OLMIS
11-3021	Computer and Information Systems Managers	\$128,337.00	OLMIS
11-3031	Financial Managers	\$118,482.00	OLMIS
11-3121	Human Resources Managers	\$103,932.00	OLMIS
13-2011	Accountants and Auditors	\$68,379.00	OLMIS
15-1121	Computer Systems Analysts	\$88,391.00	OLMIS
15-1142	Network and Computer Systems Administrators	\$79,520.00	OLMIS
43-1011	Supervisors and Managers of Office and Administrative Support Workers	\$56,808.00	OLMIS
43-4051	Customer Service Representatives	\$35,823.00	OLMIS

**Data obtained from the Oregon Labor Market Information System

Exhibit C

NARUC COST ALLOCATION AND AFFILIATE TRANSACTION GUIDELINES

Guidelines for Cost Allocations and Affiliate Transactions:

The following Guidelines for Cost Allocations and Affiliate Transactions (Guidelines) are intended to provide guidance to jurisdictional regulatory authorities and regulated utilities and their affiliates in the development of procedures and recording of transactions for services and products between a regulated entity and affiliates. The prevailing premise of these Guidelines is that allocation methods should not result in subsidization of non-regulated services or products by regulated entities unless authorized by the jurisdictional regulatory authority. These Guidelines are not intended to be rules or regulations prescribing how cost allocations and affiliate transactions are to be handled. They are intended to provide a framework for regulated entities and regulatory authorities in the development of their own policies and procedures for cost allocations and affiliated transactions. Variation in regulatory environment may justify different cost allocation methods than those embodied in the Guidelines.

The Guidelines acknowledge and reference the use of several different practices and methods. It is intended that there be latitude in the application of these guidelines, subject to regulatory oversight. The implementation and compliance with these cost allocations and affiliate transaction guidelines, by regulated utilities under the authority of jurisdictional regulatory commissions, is subject to Federal and state law. Each state or Federal regulatory commission may have unique situations and circumstances that govern affiliate transactions, cost allocations, and/or service or product pricing standards. For example, The Public Utility Holding Company Act of 1935 requires registered holding company systems to price "at cost" the sale of goods and services and the undertaking of construction contracts between affiliate companies.

The Guidelines were developed by the NARUC Staff Subcommittee on Accounts in compliance with the Resolution passed on March 3, 1998 entitled "Resolution Regarding Cost Allocation for the Energy Industry" which directed the Staff Subcommittee on Accounts together with the Staff Subcommittees on Strategic Issues and Gas to prepare for NARUC's consideration, "Guidelines for Energy Cost Allocations." In addition, input was requested from other industry parties. Various levels of input were obtained in the development of the Guidelines from the Edison Electric Institute, American Gas Association, Securities and Exchange Commission, the Federal Energy Regulatory Commission, Rural Utilities Service and the National Rural Electric Cooperatives Association as well as staff of various state public utility commissions.

In some instances, non-structural safeguards as contained in these guidelines may not be sufficient to prevent market power problems in strategic markets such as the generation market. Problems arise when a firm has the ability to raise prices above market for a sustained period and/or impede output of a product or service. Such concerns have led some states to develop codes of conduct to govern relationships between the regulated utility and its non-regulated affiliates. Consideration should be given to any "unique" advantages an incumbent utility would have over competitors in an emerging market such as the retail energy market. A code of conduct should be used in conjunction with guidelines on cost allocations and affiliate transactions.

A. DEFINITIONS

1. Affiliates - companies that are related to each other due to common ownership or control.
2. Attestation Engagement - one in which a certified public accountant who is in the practice of public accounting is contracted to issue a written communication that expresses a conclusion about the reliability of a written assertion that is the responsibility of another party.

3. Cost Allocation Manual (CAM) - an indexed compilation and documentation of a company's cost allocation policies and related procedures.
4. Cost Allocations - the methods or ratios used to apportion costs. A cost allocator can be based on the origin of costs, as in the case of cost drivers; cost-causative linkage of an indirect nature; or one or more overall factors (also known as general allocators).
5. Common Costs - costs associated with services or products that are of joint benefit between regulated and non-regulated business units.
6. Cost Driver - a measurable event or quantity which influences the level of costs incurred and which can be directly traced to the origin of the costs themselves.
7. Direct Costs - costs which can be specifically identified with a particular service or product.
8. Fully Allocated costs - the sum of the direct costs plus an appropriate share of indirect costs.
9. Incremental pricing - pricing services or products on a basis of only the additional costs added by their operations while one or more pre-existing services or products support the fixed costs.
10. Indirect Costs - costs that cannot be identified with a particular service or product. This includes but not limited to overhead costs, administrative and general, and taxes.
11. Non-regulated - that which is not subject to regulation by regulatory authorities.
12. Prevailing Market Pricing - a generally accepted market value that can be substantiated by clearly comparable transactions, auction or appraisal.
13. Regulated - that which is subject to regulation by regulatory authorities.
14. Subsidization - the recovery of costs from one class of customers or business unit that are attributable to another.

B. COST ALLOCATION PRINCIPLES

The following allocation principles should be used whenever products or services are provided between a regulated utility and its non-regulated affiliate or division.

1. To the maximum extent practicable, in consideration of administrative costs, costs should be collected and classified on a direct basis for each asset, service or product provided.
2. The general method for charging indirect costs should be on a fully allocated cost basis. Under appropriate circumstances, regulatory authorities may consider incremental cost, prevailing market pricing or other methods for allocating costs and pricing transactions among affiliates.
3. To the extent possible, all direct and allocated costs between regulated and non-regulated services and products should be traceable on the books of the applicable regulated utility to the applicable Uniform System of Accounts. Documentation should be made available to the appropriate regulatory authority upon request regarding transactions between the regulated utility and its affiliates.
4. The allocation methods should apply to the regulated entity's affiliates in order to prevent

subsidization from, and ensure equitable cost sharing among the regulated entity and its affiliates, and vice versa.

5. All costs should be classified to services or products which, by their very nature, are either regulated, non-regulated, or common to both.

6. The primary cost driver of common costs, or a relevant proxy in the absence of a primary cost driver, should be identified and used to allocate the cost between regulated and non-regulated services or products.

7. The indirect costs of each business unit, including the allocated costs of shared services, should be spread to the services or products to which they relate using relevant cost allocators.

C. COST ALLOCATION MANUAL (NOT TARIFFED)

Each entity that provides both regulated and non-regulated services or products should maintain a cost allocation manual (CAM) or its equivalent and notify the jurisdictional regulatory authorities of the CAM's existence. The determination of what, if any, information should be held confidential should be based on the statutes and rules of the regulatory agency that requires the information. Any entity required to provide notification of a CAM(s) should make arrangements as necessary and appropriate to ensure competitively sensitive information derived therefrom be kept confidential by the regulator. At a minimum, the CAM should contain the following:

1. An organization chart of the holding company, depicting all affiliates, and regulated entities.
2. A description of all assets, services and products provided to and from the regulated entity and each of its affiliates.
3. A description of all assets, services and products provided by the regulated entity to non-affiliates.
4. A description of the cost allocators and methods used by the regulated entity and the cost allocators and methods used by its affiliates related to the regulated services and products provided to the regulated entity.

D. AFFILIATE TRANSACTIONS (NOT TARIFFED)

The affiliate transactions pricing guidelines are based on two assumptions. First, affiliate transactions raise the concern of self-dealing where market forces do not necessarily drive prices. Second, utilities have a natural business incentive to shift costs from non-regulated competitive operations to regulated monopoly operations since recovery is more certain with captive ratepayers. Too much flexibility will lead to subsidization. However, if the affiliate transaction pricing guidelines are too rigid, economic transactions may be discouraged.

The objective of the affiliate transactions' guidelines is to lessen the possibility of subsidization in order to protect monopoly ratepayers and to help establish and preserve competition in the electric generation and the electric and gas supply markets. It provides ample flexibility to accommodate exceptions where the outcome is in the best interest of the utility, its ratepayers and competition. As with any transactions, the burden of proof for any exception from

the general rule rests with the proponent of the exception.

1. Generally, the price for services, products and the use of assets provided by a regulated entity to its non-regulated affiliates should be at the higher of fully allocated costs or prevailing market prices. Under appropriate circumstances, prices could be based on incremental cost, or other pricing mechanisms as determined by the regulator.

2. Generally, the price for services, products and the use of assets provided by a non-regulated affiliate to a regulated affiliate should be at the lower of fully allocated cost or prevailing market prices. Under appropriate circumstances, prices could be based on incremental cost, or other pricing mechanisms as determined by the regulator.

3. Generally, transfer of a capital asset from the utility to its non-regulated affiliate should be at the greater of prevailing market price or net book value, except as otherwise required by law or regulation. Generally, transfer of assets from an affiliate to the utility should be at the lower of prevailing market price or net book value, except as otherwise required by law or regulation. To determine prevailing market value, an appraisal should be required at certain value thresholds as determined by regulators.

4. Entities should maintain all information underlying affiliate transactions with the affiliated utility for a minimum of three years, or as required by law or regulation.

E. AUDIT REQUIREMENTS

1. An audit trail should exist with respect to all transactions between the regulated entity and its affiliates that relate to regulated services and products. The regulator should have complete access to all affiliate records necessary to ensure that cost allocations and affiliate transactions are conducted in accordance with the guidelines. Regulators should have complete access to affiliate records, consistent with state statutes, to ensure that the regulator has access to all relevant information necessary to evaluate whether subsidization exists. The auditors, not the audited utilities, should determine what information is relevant for a particular audit objective. Limitations on access would compromise the audit process and impair audit independence.

2. Each regulated entity's cost allocation documentation should be made available to the company's internal auditors for periodic review of the allocation policy and process and to any jurisdictional regulatory authority when appropriate and upon request.

3. Any jurisdictional regulatory authority may request an independent attestation engagement of the CAM. The cost of any independent attestation engagement associated with the CAM, should be shared between regulated and non-regulated operations consistent with the allocation of similar common costs.

4. Any audit of the CAM should not otherwise limit or restrict the authority of state regulatory authorities to have access to the books and records of and audit the operations of jurisdictional utilities.

5. Any entity required to provide access to its books and records should make arrangements as necessary and appropriate to ensure that competitively sensitive information derived therefrom be kept confidential by the regulator.

F. REPORTING REQUIREMENTS

1. The regulated entity should report annually the dollar amount of non-tariffed transactions

associated with the provision of each service or product and the use or sale of each asset for the following:

a. Those provided to each non-regulated affiliate.

b. Those received from each non-regulated affiliate.

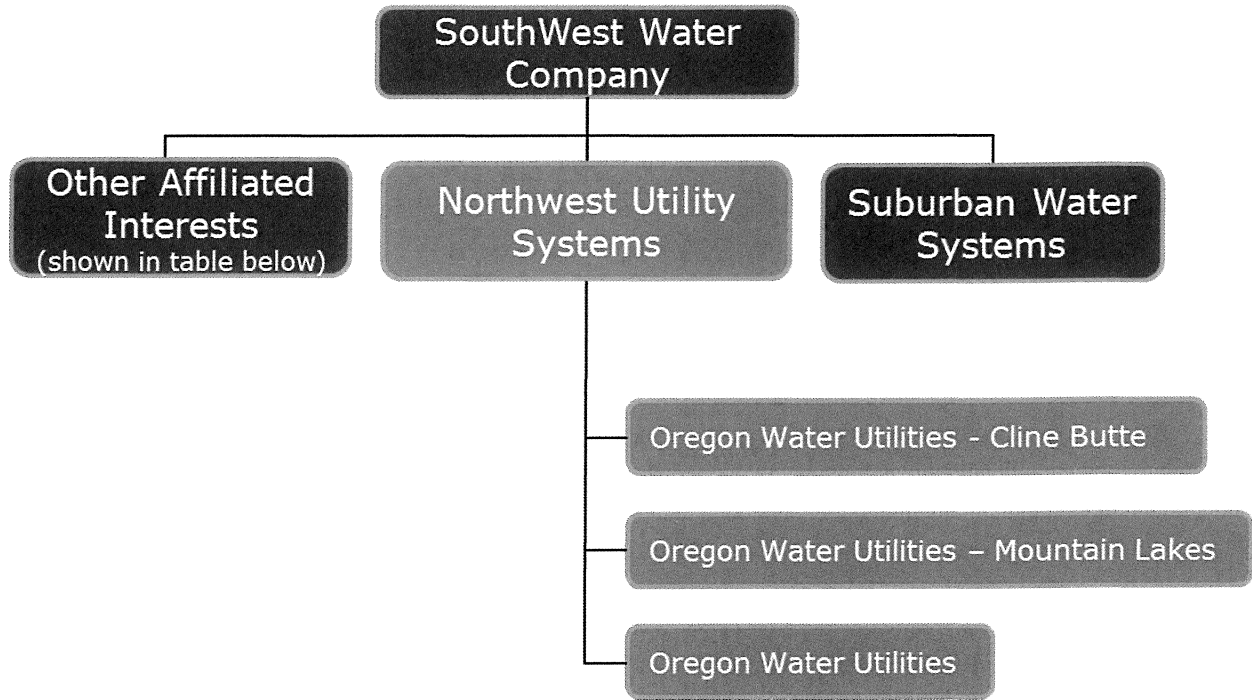
c. Those provided to non-affiliated entities.

2. Any additional information needed to assure compliance with these Guidelines, such as cost of service data necessary to evaluate subsidization issues, should be provided.

Exhibit D

SWWC OPERATIONAL ORGANIZATIONAL STRUCTURE & AFFILIATES

Exhibit D – SWWC Operational Organizational Structure & Affiliates



Other Affiliated Interests

Kiawah Island Utility, Inc.
KIU Holdings LLC
Metro - H2O Ltd.
Metro - H2O Utilities, Inc.
Monarch Utilities, Inc.
Monarch Utilities I, LP
New Mexico Utilities, Inc.
Ni America Texas, LLC
North County Water Reclamation, Inc.
Southeast Utility Systems, Inc.
SWWC Utilities, Inc.
Texas Water Services Group, LLC
TWC Utility Company, LLC