

PUBLIC UTILITY COMMISSION OF OREGON
STAFF REPORT
PUBLIC MEETING DATE: April 23, 2019

REGULAR _____ CONSENT X EFFECTIVE DATE _____ N/A _____

DATE: April 15, 2019

TO: Public Utility Commission

FROM: Malia Brock *MB*

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

SUBJECT: ASPEN LAKES UTILITY COMPANY, LLC.: (Docket No. UI 410)
Requests approval of an Affiliated Interest Relationship Agreement with Aspen Lakes Golf Course, LLC. (Office Space, Bookkeeping Services, Meter Reading and Labor)

STAFF RECOMMENDATION:

The Public Utility Commission of Oregon (Commission) should approve Aspen Lakes Utility Company, LLC.'s (Aspen Lakes or the Company) affiliated interest relationship agreement application (Application) with Aspen Lakes Golf Course, LLC (Golf Course) for the lease of office space, bookkeeping services, meter reading and labor subject to the following conditions:

1. The Company will provide the Commission access to all books of account as well as all documents, data, and records that pertain to any payments made to the Golf Course.
2. The Commission reserves the right to review, for reasonableness, all financial aspects of this transaction in any rate proceedings or alternative form of regulation.
3. The Commission limits approval of the Application to the Company's relationship with the affiliate and defers any determination regarding the costs for services provided pursuant to the informal agreement, including the application of the lower of cost or market requirements found in OAR 860-036-2230(2), to Aspen Lakes' next general rate case.

DISCUSSION:

Issue

Whether the Commission should approve the affiliated interest relationship agreement with the Golf Course and reserve review of the affiliate's cost for determination in the rate case that Aspen Lakes must file no later than June 11, 2019 pursuant to Ordering paragraph 4 of Order No. 19-002.

Applicable Law

A corporation or person has an "affiliated interest" with a public utility when it owns or holds, directly or indirectly, at least five percent of the voting securities of that public utility, is in any chain of successive ownership of five percent or more of the voting securities of such public utility, or is an officer or director of the public utility. See ORS 757.015.

When a public utility enters into a contract with an affiliated interest, it must seek Commission approval of the contract within 90 days of execution of the contract. See ORS 757.495; OAR 860-036-2210. A contract is deemed to be executed on the date the parties sign a written contract or on the date the parties begin to transact business under the contract, whichever date is earlier. See ORS 757.495.

Under OAR 860-036-2230(2)(e), 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. Under that rule, the affiliate's cost must be calculated using the water utility's most recently authorized rate of return.

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

Analysis

Background

The Application before the Commission for approval includes a non-written agreement for office space, bookkeeping services, meter reading and labor for water repairs used by the Company that is owned by, or performed by, the Golf Course and its employees.

This Agreement first came to Staff's attention in Docket No. WJ 34, an Investigation Pursuant to ORS 756.515 to Determine Jurisdiction. In the Stipulation approved by the

Commission in that docket through Order No. 19-002 on January 7, 2019, the Stipulating Parties agreed that Aspen Lakes would file all necessary affiliated interest agreement applications within 45 business days of the date of the Order. The Company filed this Application on March 2, 2019, for Commission approval in compliance with that order.

The Company is a limited liability company providing water, irrigation and wastewater services to the Aspen Lakes community. The Aspen Lakes community is comprised of 115 individual residential single family home lots, a golf course, a clubhouse and an HOA recreation building that includes a swimming pool. Of the residential single-family home lots, 86 lots either have houses or are under construction and 29 lots are vacant.

The Company owns and maintains facilities that provide residential domestic water service, residential irrigation service, commercial domestic water service, commercial irrigation service and wastewater services to the Aspen Lakes community. The wastewater facilities provide service to 19 lots in this community as the development of those lots entailed rocky ground unable to support waste elimination through a septic system. The Company also maintains fire hydrants throughout the entire development that protect all the lots whether or not the lots receive domestic or irrigation service. The lots in the Aspen Lakes community average an acre in size.

The Company is a Limited Liability Company, ownership is structured as:¹

- 1) O. Keith Cyrus, 40 percent ownership.
- 2) Matt Cyrus, 40 percent ownership and Utility decision maker.
- 3) Pam Mitchell, 20 percent ownership and Utility decision maker.

The owners hold these same percentages of shares in the affiliated interest company, the Golf Course.² As the owners are in the immediate chain of title for more than 5 percent of the voting securities of the Company and two of the owners act as directors or officers, the Golf Course qualifies an affiliated interest under ORS 757.015.

Staff reviewed the UI 410 Application and issued 25 Information Requests to clarify the following issues:

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

¹ Response to Information Request 14.

² Response to Information Request 15.

1. Terms and Conditions of the Agreement

Staff reviewed the information in the UI 410 Application, which the Company submitted for approval between the Company and the Golf Course. The Application describes a lease of office space for \$500 per month.

Additionally, the Application contains discussion of bookkeeping services provided at a cost of \$600 per month. Although the Company's initial Application reflected only bookkeeping services, in the Company's supplemental response to Staff's Information Requests 1-13, Staff learned that the Golf Course also provides meter reading and labor repairs to the water system.³ The bookkeeping, meter reading and labor repairs are included in the \$600 monthly payment.

Neither the office lease nor the labor agreement for bookkeeping, meter reading, and labor repairs are provided pursuant to a written contract.⁴ Therefore, there are no written terms of an agreement for Staff to review.

Staff's analysis and recommendation regarding the provision of office space, bookkeeping, meter reading and labor repairs from the Golf Course to the Company are discussed below.

2. Transfer Pricing

As these relationship arrangements are not formalized in a written contract, Staff views the relationship as a month to month agreement between the parties. Without the benefit of a written agreement, there are no terms for Staff to review other than the information included in the Application. The terms in the Application are described as \$500 per month for office space lease and \$600 per month for bookkeeping services.

OAR 860-036-2230(2)(e) requires that affiliated interest transactions be priced at the lower of cost or market rate. The rule 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.

³ Excerpt from Company Supplemental response titled "Supplemental answers to Staff Nos. IR 01-13." "Aspen Lakes Utility pays Aspen Lakes Golf Course \$600 per month for bookkeeping/meter reading and repair services. Meter reading and repair services are performed by our Superintendent or one of his staff."

⁴ Response to Information Request 24 and Information Request 25.

Office Space

Staff attempted to assess both cost and market rate to determine whether and to what extent a waiver of the rule would be necessary to approve this portion of the Agreement.

Affiliate's Cost. The Company states that the 180 square foot office space and additional 100 square feet of storage space used by the Company equals one percent of the total 26,000 square footage of the building in which the office is located. The office space is used by the Utility 20 percent of the time and by the Golf Course 80 percent of the time.⁵ The Company's estimated costs are depicted in Staff's Table 1:

Table 1. Estimated Monthly Cost of Current Leased Office Space.⁶

UI 410 Aspen Lakes: Estimated Mortgage Monthly Expense for Lease of Office Space			
Square Footage:			
Office Space		180 sq. ft.	
Building Sq. Footage		26,000 sq. ft.	
Percentage of Company Used Space Compared to Sq. Footage of Building		1%	
Estimated Cost	Estimated Monthly Cost	Estimated Yearly Cost	
Mortgage Cost Based on 1% of Building Space Used	\$550.00	\$6,600	
Property Tax Based on 1% of Building Space Used	\$98.00	\$1,176	
Insurance Based on 1% of Building Space Used	\$24.00	\$288	
Total Estimated Cost	\$672.00	\$8,064	
Company Estimated Percentage of Cost vs. Percentage of Use			
	% Use	Monthly Cost	Yearly Cost
Company at 20% Use	20%	\$134.40	\$1,612.80
Golf Course at 80% Use	80%	\$537.60	\$6,451.20

Included in the table are Staff's compilations of the Company's annual cost for the space leased in the building including the mortgage payment, property taxes, and insurance. As can be seen in Table 1, the annual total for those costs is \$8,064. The cost of the office space being provided to the Company is \$1,613 per year after application of the Company estimate for use of the office space as 20 percent of the time.⁷ While use of the mortgage payment is not consistent with the rule which requires use of the Company's most recent authorized rate of return, an authorized rate of return does not exist as the Company has not yet undergone a general rate case. Staff used the mortgage payment as a surrogate for the unavailable authorized rate of return in Staff's review of the cost of the office space.

⁵ Response to Staff Information Request 8(a).

⁶ Excerpt from Company Supplemental response titled "Supplemental answers to Staff Nos. IRs 01-13."

⁷ Staff excerpt of Company Response to Information Requests 3-12.

Additionally, the Company states that the cost of the phone lines, electricity, internet, postage meter lease, postage, copy machine and associated costs for maintenance and copies, as well as electricity, garbage, cleaning services and security are all considered to be included in the office rental fee. Those costs are listed in Table 2:

Table 2. Cost of Office Expenses Currently Included in the Monthly Office Lease.⁸

UI 410 Aspen Lakes Estimated Monthly Utility & Office Expense			
Estimated Costs of Utilities Provided that are Included in Lease	Use: Company/Golf Course	Estimated Monthly Cost	Estimated Yearly Cost
Postage Machine Lease		\$41.00	\$492.00
Postage		\$63.70	\$764.40
Copier/Fax/Scanner		\$181.00	\$2,172.00
Copiers NW Maintenance	200 copies per mo.	\$109.00	\$1,308.00
Bend Broadband	2 phones line + internet	\$105.00	\$1,260.00
Electric + Garbage		\$25.00	\$300.00
Total Estimated Cost of All Utilities		\$524.70	\$6,296
Company Estimated Percent of Usage			
Company at 20% Use	20%	\$104.94	\$1,259.28
Golf Course at 80 % Use	80%	\$419.76	\$5,037.12

The total cost to the Golf Course of providing the office space to the Company is \$239 per month (\$134 for the monthly cost to provide the office space in Table 1, plus an additional \$105 for monthly office expenses in Table 2 that are included in the lease).

Market Rate. The Company performed a study of the market costs for office rental space in nearby Sisters, Oregon. The Company's study found the following office spaces in nearby Sisters:⁹

- 1) 400 square feet office space available in Sisters for \$420 per month;
- 2) 785 square feet office space at \$824 per month; and,
- 3) 1385 square feet office space at \$970 per month.

The cost per square foot for these office lease spaces ranged from \$8.40 to \$12.60 per year. The Application notes that these leases do not include utilities or the associated office expenses included in the Company's lease and discussed in Table 2 above.¹⁰ Staff verified the listings provided by the Company to ensure these price ranges

⁸ Staff's excerpt of Response to Information Request 02, Attachment titled "Costs to set up a separate office and hire a bookkeeper."

⁹ Response to Information Request 13(a)(b)(c). See Attachment titled "Office Space Available".

¹⁰ Application, page 2(i).

represent accurate, reasonable market rates for the Sisters area. Staff also sought independent price quotes from www.cityfeet.com that provided only a few office space lease listing comparisons, mostly with square footages over 1,000 square feet. Staff comparison of annual lease costs ranged from \$8.40 to \$15.00 per square foot per year in Sisters.

Staff considers it prudent to consider all expenses incurred if the Company were not sharing the Golf Course office space. These expenses would include the associated utility and office monthly expenses of \$525 per month for services previously discussed that include phone lines, electricity, internet, postage meter lease, postage, copy machine and the associated costs for maintenance and copies, as well as garbage, cleaning services and security that are included in the lease.¹¹

Staff utilized the lowest price and least amount of square footage located by the Company of \$420 a month. Table 2 depicts the itemized office and utility expenses included in the current lease; Staff's conservative estimate of the cost for even the lowest priced separately leased office space in Sisters as \$945 per month or \$11,340 per year.

Cost versus market. As described above, the cost to the affiliate to provide the office space is \$239 per month and the market price is \$945 per month. Based on that analysis, the \$500 per month charged by the affiliate is greater than what it costs, based on Staff's methodology, for the Golf Course to provide this service to the utility. One approach may be a waiver of the lower of cost or market rule similar to the approach taken by Government Camp Water Company in Docket No. UI 403. In that Docket, Staff recommended approval of a waiver of the lower of cost market rule because strict application of the rule, and the accompanying lowering of the rate paid by the utility, may provide a disincentive for the affiliate to provide the office space. A similar disincentive could be put in place here and potentially result in the Utility losing access to a conveniently located office space that is priced considerably below market. Staff is not recommending the Commission make a determination on a waiver in this case.

Bookkeeping Services and Labor

Staff attempted to assess both cost and market rates to determine whether to recommend approval of an affiliate transaction for the provision of service from the Golf Course to the Company at the rates currently charged, and to determine whether and to what extent a waiver of the rule would be necessary to approve this affiliated interest.

Staff reviewed the UI 410 Application the Company submitted for reimbursement of labor for bookkeeping services in the amount of \$600 per month. As described earlier

¹¹ Response to Information Request 13(a)(b)(c). See Attachments titled "Costs to set up a separate office and hire a bookkeeper."

during Staff's discovery process, the Agreement was expanded to include bookkeeping, meter reading and labor repairs to the water system for consideration in the \$600 monthly affiliated interest agreement formerly described as bookkeeping services in the Application.¹² Staff's analysis and recommendation is discussed below.

Affiliate's Cost. Staff discovered that neither the Golf Course nor the Company appear to have records of utility expenses or track the amount of Golf Course employee time spent working for the Company. Additional Golf Course employees that perform work for the Company that are included in this Application are the water operator and meter reader, compensated at \$60,000 per year and \$15 per hour.¹³

Market Rate. The Company provided comparisons for hiring outside bookkeeping services and a comparison of hiring its own bookkeeper.¹⁴

Staff's independent analysis utilized occupation and wage information from the State of Oregon Employment Department at <https://www.qualityinfo.org>. The average hourly wages in Central Oregon for a bookkeeper is \$19.40 per hour (not including payroll taxes). The average hourly wage for meter reader is \$16.26 per hour and the yearly wage for a water and wastewater treatment plant and system operator is \$57,684.

Staff developed no market price for the meter reading and repair services because neither the Company nor the Golf Course have tracked the hours devoted to those activities.

Cost versus market. Staff is unable to determine the lower of cost or market because it cannot determine a market price at this time.

Transfer Pricing Summary for Office Space, Bookkeeping, Meter Reading and Labor. There are a number of mitigating factors involved in this filing. These factors include the fact that Aspen Lakes is new to rate regulation and, as a result, has not designed its affiliate agreements mindful of the AI regulations and requirements that accompany rate regulation. In fact, the Company does not even track many of the costs (e.g., the actual amount of time spent of the Golf Course's employee labor) associated with the services provided by affiliates. As a result, any related cost analysis may be problematic, if not impossible, to develop.

¹² Excerpt from Company Supplemental response titled "Supplemental answers to Staff Nos. IR 01-13." "Aspen Lakes Utility pays Aspen Lakes Golf Course \$600 per month for bookkeeping/meter reading and repair services. Meter reading and repair services are performed by our Superintendent or one of his staff."

¹³ Response to Information Request 18.

¹⁴ Response to Information Request 2.

Staff also discovered that no formal agreements or contracts have been issued between the affiliated companies.¹⁵ Finally, the Company advised Staff that the Golf Course is currently for sale.¹⁶ As a result, the office space, bookkeeping, meter reading and labor services provided under this relationship Agreement may change dramatically by the time the Company's upcoming rate case is finalized.

In summary, Staff recommends that the Commission approve the Application insofar as the relationship between the Company and the Golf Course exists, but reserve the application of transfer pricing for the office space, bookkeeping, meter reading and labor services for the upcoming rate case. In the Company's general rate case, Staff will also review and make recommendations regarding the prudence of costs and the appropriate ratemaking treatment for services provided.

Approval of Staff's recommendation here does not constitute ratemaking treatment and the Company's costs will be separately considered in the context of establishing overall fair and reasonable rates in the rate case.

4. Public Interest Compliance

The Commission customarily applies a no harm standard to affiliated interest relationship agreements.

Office Space. Staff finds the lease and the convenience of having the Company office located in Sisters, in an area that registers substantial amounts of snow in the wintertime and possesses few opportunities of office space for lease, to be in the public interest. Customers could potentially be harmed by not approving this relationship agreement, as this could lead the Company to lose access to the office space and incur immediate costs associated with moving records and securing alternative office or home office space. The office space also appears to be provided at a significant discount to the relevant market price.

Bookkeeping, Meter Reading and Labor. The Company would be required to hire employees to perform services currently completed by Golf Course employees. Shared labor with the Golf Course is considered to be beneficial to customers as this relationship provides the necessary labor at a shared cost to customers. The upcoming rate case will provide Staff the ability to review all costs before they are put into customer's rates.

¹⁵ Response to Information Request 24 and Information Request 25.

¹⁶ <http://www.keen-summit.com/projects/bankruptcy-sale-aspen-lakes-golf-course-and-development-sisters-oregon/>.

Finally, given that Staff is recommending that further review occur before the expenses for the office space, bookkeeping services, meter reading and labor are allowed into rates, customers will not be harmed by approval of this relationship agreement.

5. Records Availability, Audit Provisions, and Reporting Requirements

Proposed conditions numbers 1 through 3 above, together with the Commission's authority over water utilities, afford the Commission the necessary opportunity to examine the Company's records and activity regarding the cost of this relationship agreement.

Conclusion

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

1. The application regards an affiliated interest relationship agreement that is fair and reasonable and not contrary to the public interest, with the inclusion of proposed ordering conditions.
2. Necessary records are available.

PROPOSED COMMISSION MOTION:

Approve Aspen Lakes Utility Company Inc.'s application for approval of an Affiliated Interest relationship with Aspen Lakes Golf Course, LLC., subject to the three recommended conditions listed above.