

**PUBLIC UTILITY COMMISSION OF OREGON
STAFF REPORT
PUBLIC MEETING DATE: August 28, 2018**

REGULAR _____ CONSENT X EFFECTIVE DATE _____ N/A _____

DATE: August 21, 2018

TO: Public Utility Commission

FROM: Malia Brock MB

THROUGH: Jason Eisdorfer EP, Bryan Conway BCC, and Bruce Hellebuyck BH

SUBJECT: GOVERNMENT CAMP WATER COMPANY: (Docket No. UI 403)
Requests approval of an Affiliated Interest Agreement with Maryanne Hill and Waiver of OAR 860-036-2230(2)(e) and OAR 860-032-2210(2).
(Office)

STAFF RECOMMENDATION:

The Public Utility Commission of Oregon (Commission) should approve Government Camp Water Company's (Government Camp or the Company) affiliated interest agreement (Agreement) with Maryanne Hill for the lease of home office space, 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 to Ms. Hill.
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 Company will notify the Commission in advance of any substantive changes to the Agreement, including any material change in price above the \$7,000 annual contract price approved as the result of adopting Staff's recommendation here. Any such changes shall be submitted in an application for a supplemental order (or other appropriate format) in this docket.
4. If extended beyond its initial term, the Agreement shall not include any automatic increases in price for subsequent lease terms without Commission approval.

DISCUSSION:

Issue

Whether the Commission should approve the affiliated interest contract with Maryanne Hill and waive OAR 860-036-2230(2)(e) and OAR 860-036-2210(2).

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).

Under OAR 860-036-1000(3), the Commission may waive any of its water division rules upon a written request and good cause shown.

Analysis

Background

The Agreement before the Commission for approval is for office space used by the Company in a home in Government Camp that is owned by Ms. Hill.

The Agreement first came to Staff's attention in the Company's rate case that is currently pending in Docket No. UW 174, which was filed on December 29, 2017. After Staff notified the Company that the Agreement would require Commission approval, the

Company filed an application for Commission approval of the Agreement in Docket No. UI 398 on March 30, 2018. After Staff notified the Company that its filing did not contain information regarding the affiliate's costs, as required by the application, the Company withdrew that filing. The Company subsequently filed this revised version of the application in Docket No. UI 402 on June 5, 2018.¹

The Company is a small family investor owned, rate and service regulated water utility that provides water to an unincorporated area in Government Camp, Oregon. It provides water service to approximately 660 homes and businesses. Customers include permanent and part-time residents, multi-family condominium complexes and home owner associations, and snow resorts.

Shares of the Company are entirely held by Ms. Hill's daughter, Ms. Bekins, pending the outcome of Docket No. UP 375. Ms. Hill previously held these shares (and is therefore is in the immediate chain of title for more than 5 percent of the voting securities of the Company), and is additionally the President of the Company (and is therefore an officer). Ms. Hill therefore qualifies an affiliated interest under ORS 757.015.

Staff reviewed the Agreement, issued ten information requests, and did a site visit to the office in the course of investigating the following issues:

1. Terms and Conditions of the Agreement;
2. Waiver of OAR 860-036-2210(2);
3. Transfer Pricing, including Waiver of OAR 860-036-2230(2)(e);
4. Public Interest Compliance, and;
5. Records Availability, Audit Provisions, and Reporting Requirements.

1. Terms and Conditions of the Agreement

Staff reviewed the Agreement between the Company and Ms. Hill. While the Agreement appears to be similar to other property rental agreements typically used by water utilities, the Agreement also includes an automatic escalation clause whereby the annual price of the Agreement (initially, \$10,000 annually) will increase automatically by two percent effective January 1st each year starting in 2019, if the initial yearlong term of the lease is extended. Staff's analysis and recommendations regarding the rent and rent increases are discussed below, in connection with pricing.

2. Waiver of OAR 860-036-2210(2)

The Agreement was signed on March 30, 2018, but the effective date stated in the

¹ At the same time, the Company filed an application for approval of the transfer of all company stock to Ms. Bekins (Docket No. UP 375) and two additional affiliated interest agreements (Docket Nos. UI 402 and UI 404). At the Company's request, the extension period for its currently pending rate case was extended to accommodate these filings. See Order Nos. 18-179 (Docket No. UW 174).

Agreement is January 1, 2018. Because the parties began transacting according to the Agreement as of January 1, 2018, the date of execution of the Agreement for the purposes of ORS 757.495(2) and OAR 860-036-2210(2) is January 1, 2018.

Both the statute and rule require a contract to be filed with the Commission no later than 90 calendar days after its date of execution. The Company initially filed the agreement on March 30, 2018, at the end of the 90-day period. That application was incomplete, due to a lack of cost information, which is necessary information to inform the Commission's full consideration of the Agreement. The subsequent application, filed on June 5, 2018, was filed after the 90-day window had closed.

Staff recommends that the Commission waive OAR 860-036-2210(2) here, as the Company cooperated with Staff in revising its application and coordinating the filing of multiple simultaneous applications consistent with ongoing conversations with Staff. For the same reason, Staff does not recommend any action be taken on the basis of the application in this particular docket having been filed after the 90-day statutory window. This should not be interpreted as support for non-compliance with respect to any other agreement, or any future amendment to this agreement.

3. *Transfer Pricing, including Waiver of OAR 860-036-2230(2)(e)*
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.

The Company requests waiver of this rule, so Staff assessed both cost and market rate to determine whether and to what extent a waiver of the rule would be necessary to approve the Agreement.

Affiliate's Cost. The Company states that because the costs of maintaining the home are shared, cost for providing the space is difficult to determine. The Company estimates that the cost attributable only to the Company's presence in the home is "near zero."² The Company also provided the following household total costs for maintaining the home in 2016 and 2017, not including property taxes, listed in Table 1 on the following page.³

² Application at 3.

³ Application at 3.

Table 1⁴

Shared Expenses for 2016/2017	
Oil	\$ 3,851.22
Sewer	\$ 959.40
Garbage	\$ 545.60
PGE Power	\$ 2,316.87
Snow Removal/Misc.	\$ 2,969.00
2016/2017 Total Cost	\$10,642.09
Average Annual Cost	\$ 5,321.05

The Company does not apportion these costs between the portion of the home used by the Company or the percentage of time that parts of the home are used as an office.

Staff estimates that the cost in this case is \$1,330 per year. Using Table 1 above, the total annual average of the 2016 and 2017 cost of the home minus insurance is \$5,321. As will be discussed later, Staff estimates that the Company should be considered to utilize 25 percent of the home's total square footage for the purpose of assessing its requested waiver, which represents \$1,330 as the average annual estimated cost. The application additionally characterized the affiliate's costs as "near zero."

Market Rate. The Company performed a study of the market costs for office rental space in nearby Clackamas, Oregon. At the time of the study, the Company states that there were no comparable office spaces available in Government Camp. The Company estimates that the office rental space in Clackamas County ranges from \$12 per square foot to \$28 per square foot per year.⁵ For the purposes of this application, the Company calculated the market rate using the lowest of these figures, \$12 per square foot per year, and arrived at a market rate of \$10,800 annually, based on its own estimate of the Company using 900 square feet of Ms. Hill's home.

Staff verified the listings provided by the Company to ensure the range of prices represents accurate, reasonable market rates for the Clackamas area. Staff also sought price quotes from Fort Deposit Self Storage and Business Park in Welches, but the provider declined to disclose a price in response to Staff's inquiry because all units were rented at that time. To estimate market value, Staff therefore used the same lowest market rate provided in the Company's market survey, or \$12, as the representative price per square foot per year. Staff notes that the comparable market

⁴ Staff removed the cost for personal insurance on the home, as the Company has its own separate policy and coverage.

⁵ Application at 4.

rates for office rental space is likely for a superior space, so the use of the lowest available rate as a market comparator is appropriate. In the comparables put forward by the Company, a potential tenant would have full, unfettered use of the space. In the case of Ms. Hill's home, all of the areas listed as office space are shared with residential tenants. For this reason, Staff recommends using the low end of the range of prices per square foot to calculate a market rate.

Staff assessed the amount of the home used by the Company and how the space is being used. The Company asserts that the Company uses 900 square feet of the home, which reflects a substantial increase over the 375 square feet that was noted in testimony supporting the stipulation resolving the Company's last rate case in Docket No. UW 145. Staff reviewed a floor plan of the home with very rough estimated dimensions of space that were estimated and provided by the Company.⁶ Staff also conducted an onsite visit on August 6, 2018, to view the spaces used by the Company.

Staff observed that all spaces used by the Company in the property are mixed use. The largest meeting area is a living room or parlor that contains numerous pieces of furniture and no storage; the main workspace for the Company, with an in-use printer and recent Company files, is a dining room; and assorted Company storage occupies portions of two bedrooms, a seasonal deck, and the basement. Which locations that the Company uses to work and to store Company records appear to be left to the discretion of the Company. While some shelves were relatively full, elsewhere, storage boxes were stacked in low rows on the floor. No room is exclusively used by the Company. Additionally, some storage spaces that are used by the Company also house household items, such as greetings cards, a gun cleaning kit, a plant container, vases, lamps, and decorative items. Company records generally appeared to date back to the 1980s. A large printer and scanner stored in the basement did not appear to be in regular use. A large desk in the basement appeared to duplicate workspace available elsewhere in the home, and additionally housed household items in several of its drawers. Finally, as the application notes, the spaces used by the Company lack definitive spatial segregation.

On the basis of these onsite observations, Staff believes that for the purposes of assessing the market rate of the space rented by the Company and assessing its requested waiver of the transfer pricing rule, the 900 square feet figure put forward by the Company is too high. Staff estimates an alternative figure of 474 square feet would be more appropriate, as shown below in Table 2. This figure is based on the total amount of space in the entry; the main floor parlor (which, if used exclusively as an office, could also serve to store files); a portion of the main floor kitchen and dining areas, including the hallway to the bathroom; and the main floor bathroom (not including a bathroom storage area).

⁶ Response to Information Request 02. See Attachment A, Pages 1-5.

Due to the lack of an area dedicated to storage and the various types and sizes of storage items implemented, Staff's performed an analysis of the volume of files stored in the areas added since Docket No. UW 145: the basement, deck, and bedrooms. Based on measurements taken during the onsite visit, Staff's estimates 176.45 square feet as the volume of the records stored in the areas Staff did not include in Table 2 below. Consolidating this volume of files into seven 42" X 18" standard filing cabinets with a height of 62.5", the seven cabinets could be stored along the parlor area walls. As the seven standard filing cabinets would utilize 36.75 square feet, Staff estimated an additional 23.67 square feet would be necessary for the drawing table and maps, which would result in 60 square feet of storage required. Staff's believes these items could be easily stored in a space of 235 square feet, the approximate size of the main floor parlor, and still leave sufficient space to meet with customers. Staff also recommends not approving storage space for the large wooden desk and printers mentioned earlier, as these types of items are duplicated elsewhere in the home. Staff's measurements of the areas varied slightly from those provided by the Company. The Company's account of the space used and Staff's market analysis are both summarized in Table 2.

Table 2.

Staff Measurements of Office Space UI 403			Allowance UW 145	Footages Provided in Company Application	
Area	Measurement	Sq. Footage		Area	Sq. Footage
Entry	4 X 5	20		4 X 5	20
Main Floor Parlor	13'7" X 17'4"	235		16 X 18	288
Main Floor Bathroom	6'5" X 6'10"	44		9 X 10	90
Ingress/Egress	12 X 7'5"	89		9 X 7.5	66.75
Main Floor Outside Deck				10 x 7	70
Main Floor Bedroom				5 x 11	55
Main Floor Kitchen	10 X 8'7"	86		9 X 7.5	66.75
2nd Floor Bedroom				10 X 7	70
Basement Area				20 X 6 + 6 x 9	174
Total Sq. Feet Used by Company		474	375 sq. feet	sq. footage	900.5

Annual Lease at the Market Rate of \$12 per sq. ft.	\$ 5,690
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Waiver of OAR 860-036-2230(2). In this case, the affiliate's cost (\$1,330, per Staff's estimate above) is significantly lower than the market rate, no matter how the market rate is measured (from the Company's \$10,800 to Staff's \$5,690 annually). If the Commission were to strictly apply its transfer pricing rule as described in OAR 860-036-2230(2)(e), the Company's proposed contract price would exceed the affiliate's cost.

The Company requests that the Commission waive this rule in this instance. The Company asserts that if the Agreement were approved only at cost, it may provide a disincentive for Ms. Hill to allow the Company to use her home and would give a "windfall" to ratepayers. Staff recognizes that will Ms. Hill's planned retirement at the conclusion of the Company's current rate case, there is some risk of this disincentive, but due to the nature of the space in the home, Staff believes that a full market rate, at the level it would be calculated by the Company, is not necessary in this case. Additionally, while the location of the office is desirable, Staff understands customer contact onsite to be relatively infrequent. Finally, local file storage is probably less critical for some older files, although it is certainly useful for plant and current customers.

For these reasons, Staff supports a limited waiver of the rule contained in OAR 860-036-2230(2)(e). Staff recommends that the Commission approve an annual lease amount for this Agreement of \$7,000. While well above the affiliate's cost, this \$7,000 annual figure is still lower than the Company's market rate estimate discussed above. At a 30 percent decrease from the amount reflected in the Company's application, Staff believes this amount is sufficient to provide a strong incentive to continue leasing the property to the Company, while also protecting ratepayers. The increase of storage space to 474 square feet represents an approximate 26 percent increase of the square footage allotted in Docket No. UW 145 of 375 square feet.

Staff arrived at this recommendation by applying the lowest market rate of \$12 per square foot provided in the Company's market analysis to Staff's estimated square footage requirement of 474 square feet, for an annual market analysis rate of approximately \$5,690, plus the average estimated cost of utilities of \$1,330 per year, for a total of \$7,020 annually. Staff believes a price that reflects approximately 25 percent of the utilities is generous, given that utility usage for residential versus business use are not limited by business hours.

As the space is mixed use and none of the spaces are designated solely to the Company, Staff rounded down the total lease amount to \$7,000 annually.

A second comparison uses the Zillow estimate that this home would rent for \$1,799 dollars per month. Staff estimates the Company's space requirement of 474 square feet utilizes 25 percent of the home's 1,880 square footage, which would represent a \$5,444 annual residential market rate. Including utilities estimated at \$1,330 per year, the Zillow-provided market rate analysis including utilities would be \$6,774 yearly. This figure is roughly in line with the market estimate Staff developed above and provides additional confidence that Staff's recommendation is fair and reasonable. Staff does not recommend allowing the automatic increase of this price by 2 percent in subsequent terms of the Agreement. While Staff is confident that an annual price of \$7,000 is *currently* below a high market valuation, market value fluctuates. Staff has no

reason to believe that perpetual increases would result in below-market prices in the future. In a down market, such an automatic escalator may harm ratepayers if it obligates the Company more than it is able to pay. Staff recommends conditions disallowing this increase and requiring the Company to seek Commission approval of material changes.

Staff also does not recommend that the waiver of OAR 860-036-2230(2)(e) include any additional amount for the Company to pay property taxes over the \$7,000. While the lease does not appear to refer include such a requirement, Staff mentions it here out of caution because the application refers to where it would record property tax payments.⁷

Alternatively, if the Commission does not grant the waiver and approve the above amounts, Staff proposes that the Commission approve the Agreement at an annual price of \$1,330, the affiliate's costs identified above.

Finally, Staff notes that a \$7,000 annual price for this Agreement reflects an increase in the Company's expenses for the analogous lease over the \$5,000 per year that was included in its last rate case.⁸ Approval of Staff's recommendation here does not constitute ratemaking treatment. The Company's costs will be separately considered in the context of establishing overall fair and reasonable rates.

4. Public Interest Compliance

The Commission customarily applies a no harm standard to affiliated interest agreements. Staff finds the lease and the convenience of having the Company office located in Government Camp in an area that registers feet 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 the Agreement, as this could lead the Company incur immediate costs associated with moving records and securing alternative office or home office space. Given that further review will occur before these expenses are allowed into rates, customers will not be harmed by approval of the Agreement and the requested rule waiver.

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 Agreement.

Conclusion

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

⁷ Application at 4.

⁸ Docket No. UW 145, Order No. 11-278 (July 29, 2011).

1. The application regards an affiliated interest agreement that is fair and reasonable and not contrary to the public interest, with the inclusion of proposed ordering conditions.
2. Good cause exists to waive OAR 860-036-2210(2).
3. Necessary records are available.
4. Good cause exists to waive OAR 860-036-2230(2)(e) and allow an above-cost Agreement price of \$7,000 per year, exclusive of automatic increases or additional amounts, with the inclusion of the proposed ordering conditions.

PROPOSED COMMISSION MOTION:

Approve Government Camp Water Company's application for the Affiliated Interest Agreement with Maryanne Hill, for \$7,000 per year, subject to the four recommended conditions listed above, and waive the cost requirement of OAR 860-036-2230(e) and the 90-day requirement of OAR-036-2210(2) for good cause shown.

IR 02

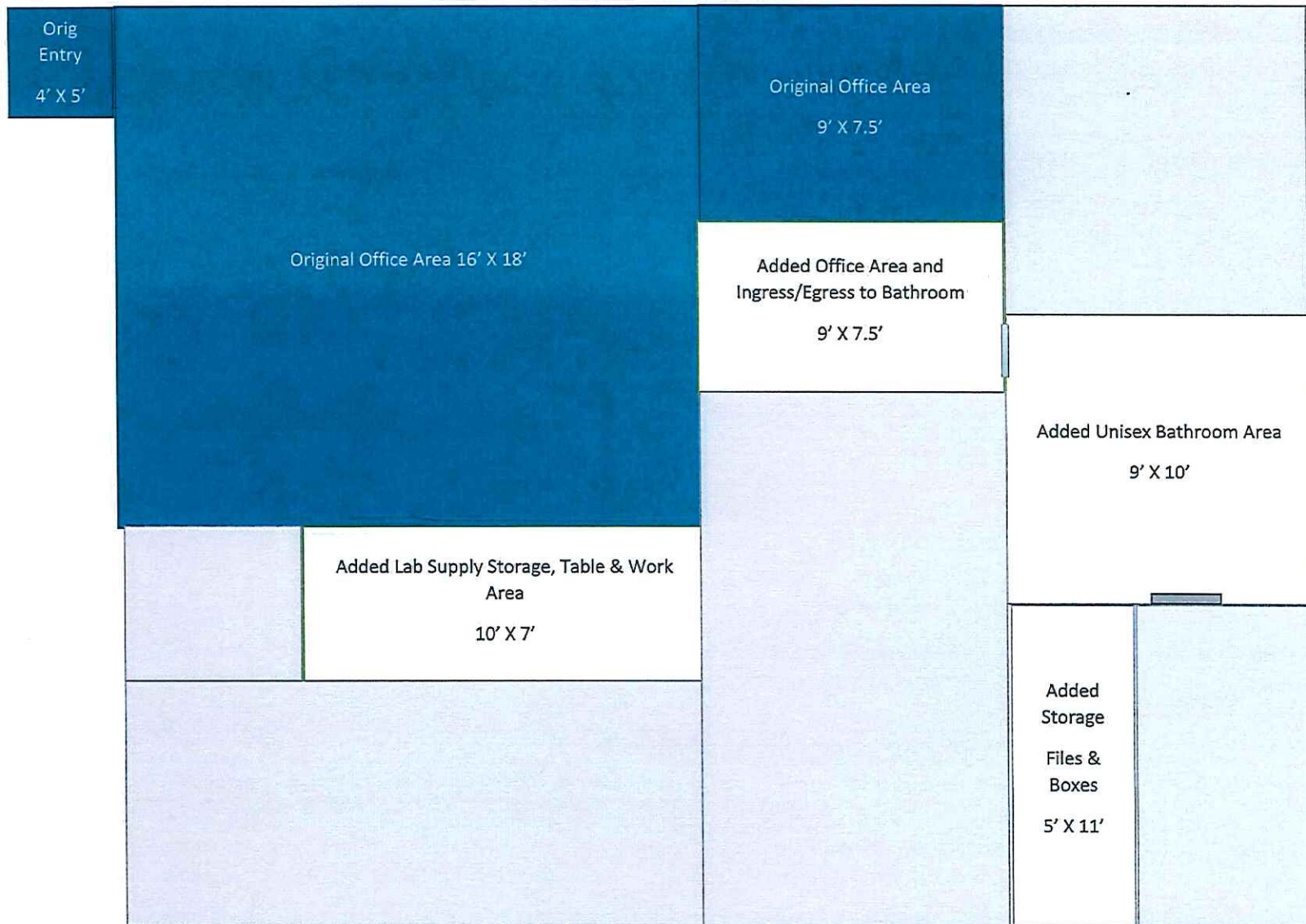
Please provide a floor plan of the home that includes the measurements of the dimensions of the area(s) of the home that are used by the Company, if available.

RESPONSE:

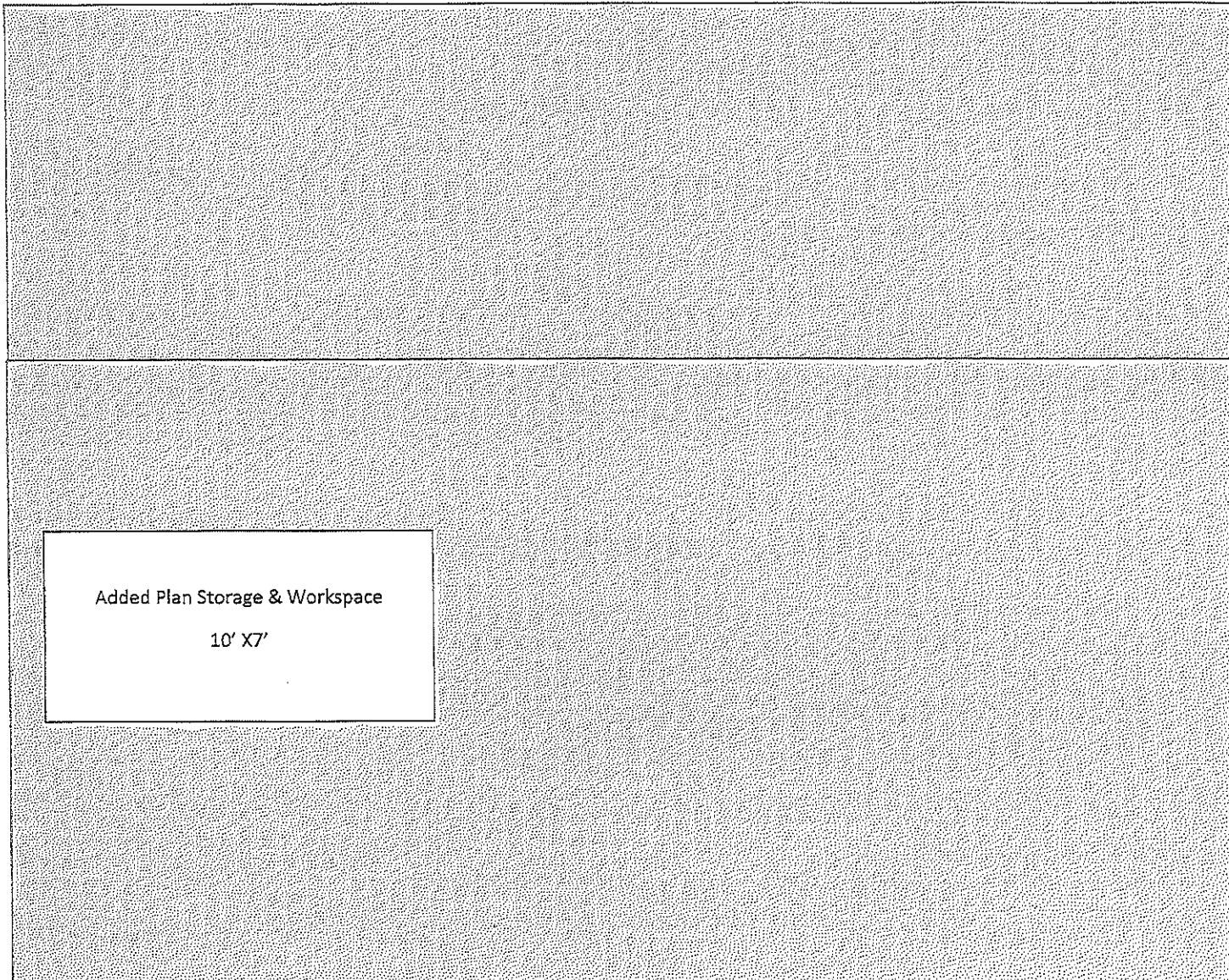
See the attached layout of the home (not to scale), dimensions, and square feet of areas used by the Company.

Office Space/Storage						
	Original Office Space			Additional Added		
	Entry	Ofc	Ofc	Ofc Storage	Bathrm	
Width	4	9	16	9	9	
Length	5	7.5	18	7.5	10	Total Space
Sq. Ft.	20	67.5	288	67.5	90	533 sq ft
Storage						
	1st Flr	1st Flr	2nd Flr	Basement	Basement	
Width	10	5	10	20	6	
Length	7	11	7	6	9	Total Storage Space
Sq. Ft.	70	55	70	120	54	369 sq ft
						902 Total Sq Feet

In the layout below: 1) it is not to scale, 2) lines do not indicate walls, 3) not all doors are shown



2nd Floor



Basement

