

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

REGULAR _____ CONSENT X EFFECTIVE DATE _____ N/A _____

DATE: April 10, 2019

TO: Public Utility Commission

FROM: Russ Beitzel 

THROUGH: Jason Eisdorfer, Bryan Conway, and Bruce Hellebuyck 

SUBJECT: ASPEN LAKES UTILITY COMPANY, LLC.: (Docket No. UI 411) Requests approval of an Affiliated Interest Relationship Agreement with Sister's Aggregate and Construction, LLC. (Heavy Equipment Rental)

STAFF RECOMMENDATION:

The Public Utility Commission of Oregon (Commission) should approve Aspen Lakes Utility Company, LLC.'s (Utility) affiliated interest relationship with Sister's Aggregate and Construction (Sister's) for the lease of heavy equipment subject to the following conditions:

1. The Utility will provide the Commission access to all books of account as well as all documents, data, and records that pertain to any payments to Sister's.
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 Utility'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 with Sister's 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 Affiliated Interest Relationship before the Commission for approval is for a monthly lease for heavy equipment that is owned by Sister's, but used by the Utility on an as-needed basis.

This Affiliated Interest first came to Staff's attention in Docket No. WJ 34 asserting rate regulation. In the Stipulated Agreement reached between parties in Order No. 19-002 on January 7, 2019, condition Number 3 agrees that the Utility would file all necessary

affiliated interest agreement applications within 45 business days of the entered date of the Order. The Utility filed this affiliated interest agreement on March 2, 2019, for Commission approval in accordance to this agreement.

The Utility is a limited liability company providing water and wastewater utility services to the Aspen Lakes community (Aspen Lakes). Aspen Lakes 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 Utility owns and maintains facilities that provide residential domestic water service, residential irrigation service, commercial domestic water service, commercial irrigation service and wastewater services to Aspen Lakes. 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 Utility also maintains fire hydrants throughout the entire development that protect all lots whether or not the lots receive domestic or irrigation service. The lots in Aspen Lakes are an average of an acre in size.

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

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

Sister's is a Limited Liability Company, ownership is structured as:²

- 1) O. Keith Cyrus, 33 percent ownership.
- 2) Matt Cyrus, 33 percent ownership.
- 3) Pam Mitchell, 33 percent ownership.

As the owners are in the immediate chain of title for more than 5 percent of the voting securities of the Utility and all of the owners act as directors or officers, Sister's Aggregate and Construction, LLC qualifies as an affiliated interest under ORS 757.015.

Staff reviewed the UI 411 Application and issued ten information requests in the course of investigating the following issues:

1. Terms and Conditions of the Agreement;

¹ Response to Information Request 05.

² Response to Information Request 06.

2. Transfer Pricing,
3. Public Interest Compliance, and;
4. Records Availability, Audit Provisions, and Reporting Requirements.

1. Terms and Conditions of the Agreement

Staff reviewed the UI 411 Application the Utility submitted for reimbursement between the Utility and Sister's. The Application describes a monthly lease payment of \$1,500 for unlimited use of the heavy equipment owned by Sister's. Staff's analysis and recommendation is discussed below. The Agreement is just an arrangement that is not formalized into a written contract. As a result, there are no terms to review other than the information contained in the application.

2. Transfer Pricing

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.

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 the Relationship, issuing ten Information Requests to the Utility.

Affiliate's Cost. The Utility stated in its Application that "if the utility co. had to purchase the equipment needed to maintain the system the cost to customers would be prohibitive." Staff agrees to the extent that the equipment would be idle for the majority of its useful life and the Utility is not in the business of renting heavy equipment.

The Utility stated that over calendar years 2017-2018 the "Backhoe was used 4 times, the Dump Truck was used 0 times and the Rock Saw was used 0 times."³ Additionally, the Utility provided the information summarized in the table below:⁴

³ Response to Information Request 08a.

⁴ Response to Information Requests 08b-d.

Model:	Cost:	Approx. Net Book:	Depr/yr:
Case 580K Backhoe	27,000	14,580	540
1980 Int'l Dump Truck	8,000	4,190	381
Ditchwitch Rock Saw 6510	40,000	22,400	800
Total	75,000	41,170	1,721
10% return		4,117	

Staff estimates that the cost for depreciation is \$1,721 per year for all pieces of equipment. The Utility has not been in for a rate case so it has no "most recently authorized rate of return" to calculate its costs as prescribed by the rule. Assuming a ten percent rate of return Staff estimated the capital cost associated with the Net Book value to be \$4,117. Due to a lack of usage or other available information, Staff could not calculate annual maintenance costs for the equipment. Staff calculated the annual cost of owning the equipment, excluding maintenance, to be \$5,838 (\$1,721+\$4,117).

Market Rate. The Utility stated that the rental rates for the referenced equipment from Sister's are as follows: "rental rates for the backhoe are \$295 per day plus \$100 delivery, not available after hours. The Dump Truck rents for \$200 per day and the Rock Saw rents for \$1,200 per day, plus delivery."⁵ Additionally, the Utility stated that "the \$1,500 rate was chosen based on the estimated average monthly use of the above equipment and their competitive daily rental rates. This would allow one day each for the Backhoe and the Rock Saw (without delivery charge)."⁶ Given that 80 percent of the proposed monthly affiliated expense of \$1,500 was based on the use of the Rock Saw, which has not been used in the past two full calendar years, Staff is concerned about the actual use in determining the cost of the monthly rental fee.

Staff's research into available heavy equipment rental options in the Sister's, OR area showed that without using Sister's, the Utility would have to rent from either Redmond, OR or Bend, OR. Both Redmond and Bend are approximately a thirty minute drive from the Utility, require a delivery fee and may not offer after-hours rental for all equipment. In the case of the Rock Saw, the Utility owners informed Staff that "Rock Saws can only

⁵ Response to Information Request 01b.

⁶ Response to Information Request 04.

be rented by the week.”⁷ Staff was unable to find a rental price of a Rock Saw that matches the model of the one available at Sister’s in the Redmond or Bend area, but recognize that a weekly requirement would be cost prohibitive for a single use requirement.

The Backhoe and Dump Truck rental prices provided above by Sister’s both appear reasonable. Most businesses do not post their rental prices on their website. Staff found one comparable rental price of a ‘mini backhoe loader’ at 5G Equipment Rentals in Bend, OR, which is a smaller backhoe, but similar in function to Sister’s Case 580K Backhoe. The rental price is \$225 per day. Staff found a comparable Dump Truck rental price at Herc Rentals in Portland, OR. The rental price is \$300 per day.

Finally, the Utility stated “there is no formal written agreement between SAC and ALU”.⁸ Staff recommends that the Commission approve the affiliated relationship between the Utility and Sister’s and review the costs for renting heavy equipment for prudence in the rate case.

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.

3. Public Interest Compliance

The Commission customarily applies a no harm standard to affiliated interest relationships. Staff finds the lease with the convenience of having the equipment located on same property and available on demand to be in the public interest. Customers could potentially be harmed by not approving the relationship, as this could lead the Utility to incur substantially higher costs to rent the equipment from a more distant location. Given that further review will occur before all expenses for the equipment rental are allowed into rates, customers will not be harmed by approval of the relationship.

4. 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 Utility’s records and activity regarding the relationship.

⁷ Response to Information Request 07.

⁸ Response to Information Request 10.

Conclusion

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

1. The Application regards an affiliated interest relationship 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 an Affiliated Interest relationship with Sister's Aggregate and Construction, LLC., subject to the three recommended conditions listed above.