


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 412) Requests approval of an Affiliated Interest Relationship Agreement with Wildhorse Meadows, LLC. (Water and Land Use Easement Royalty)

**STAFF RECOMMENDATION:**

The Public Utility Commission of Oregon (Commission) should approve Aspen Lakes Utility Company, LLC.'s (Utility) affiliated interest relationship with Wildhorse Meadows, LLC (WHM) for the payment for use of land and water derived from that land 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 WHM.
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 the WHM 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 an annual royalty payment for the water and land used by the Utility that is owned by WHM.

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:<sup>1</sup>

- 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.

The owners hold these same percentages of shares in the affiliated interest company, Wild Horse Meadows, LLC.<sup>2</sup> As the owners are in the immediate chain of title for more than 5 percent of the voting securities of the Utility and two of the owners act as directors or officers, Wild Horse Meadows, LLC qualifies as an affiliated interest under ORS 757.015.

Staff reviewed the UI 411 Application and issued seventeen information requests in the course of investigating 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. Terms and Conditions of the Agreement*

Staff reviewed the UI 412 Application the Utility submitted for reimbursement between the Utility and WHM. The Application describes a yearly 10 percent royalty payment to WHM based on all revenue derived by the Utility from water and wastewater services. In exchange for the 10 percent royalty, the Utility receives 1) the use of land upon which the utility's well, water pump facilities and waste water facilities are located, and 2) water from Water Permit G-11578 which is used primarily for irrigation purposes. The

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<sup>1</sup> Response to Information Request 06.

<sup>2</sup> Response to Information Request 07.

accrued royalty for the prior three calendar years 2016-2018 is \$10,704, \$16,560 and \$16,177, respectively.<sup>3</sup> The utility also draws water associated with Water Permit G-11576 from the pump located on that facility, but the Utility owns that permit. The terms of the Agreement are laid out in an Easement Agreement between the Utility and WHM. Staff's analysis and recommendation is discussed below.

## 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 seventeen Information Requests to the Utility.

*Affiliate's Cost.* The Utility stated that "the purchase price of the land was approximately \$1000 per acre for 383 acres or \$383,000. Property taxes are for the 2018-2019 year \$19,122."<sup>4</sup>

**Table 1**

Item:	Size in Sq. Ft:
Water Facility	10,000
Pipeline	28,500
Easement	2,000
Sewer Facility	43,560
Total	84,060
WHM Land	16,683,480
Utility use of WHM Land	0.50%

<sup>3</sup> Response to Information Request 15.

<sup>4</sup> Response to Information Request 10.

Applying the above usage percentage to the total cost of the land owned by WHM, Staff calculated the purchase price applicable to the land used by the Utility to be \$1,930 ( $\$383,000 * .5\%$ ) plus an additional estimated \$20,000 per permit.<sup>5</sup>

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 10 percent rate of return, the Utility's yearly cost of the land would be \$2,193 ( $\$1,930 * 10\% + \$20,000 * 10\%$ ) plus an additional \$96 ( $\$19,122 * .5\%$ ) for property taxes, for a total annual cost of \$2,289.

In summary, Staff estimates the total cost to be \$21,930 for the purchase price of the land and the permit resulting in an annual cost of \$2,289 for a return on investment and property taxes.

*Market Rate.* The current rates for purchasing land in Deschutes County, OR are shown in the table below.

Table 2

	Acres	Cost	Cost/Acre
Current Land cost in Sisters	244	800,000	3,279
Source: Landwatch.com	138	1,299,000	9,413
	158	299,000	1,892

The Utility uses approximately 84,060 square feet or two acres. If the current market price per acre is applied, that land use is valued between \$3,800 and \$18,800. The yearly cost for the land would be between \$380 and \$1,880 for a return on investment without property taxes. Staff was unable to find market comparators for the value of the water provided by WHM under Water Permit G-11578.

The Utility provided the Easement Agreement between WHM and the Utility, which states "the Utility Company shall pay to Wildhorse ten percent (10%) of all revenues that Utility Company receives from the supplying of water and from the provision of waste water treatment services to the Golf Course Property and all other customers of the Utility..."<sup>6</sup> Due to the lack of available options for benchmarking a royalty agreement for an easement to a water utility, Staff recommends that the Commission approve the

<sup>5</sup> Response to Information Request 09a.

<sup>6</sup> Response to Information Request 05.

affiliated relationships between the Utility and WHM and review the costs for the royalty agreement for prudence in the rate case.

Approval of Staff's recommendation here does not constitute ratemaking treatment. The Utility'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 relationship between the Utility and WHM is in the public interest. Customers potentially could be harmed by not approving the relationship, as this could force the Utility to move its facilities and find a new water source. Given that further review will occur before all expenses for the royalty 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.

## 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 approval of an Affiliated Interest relationship with Wildhorse Meadows, LLC., subject to the three recommended conditions listed above.