

**PUBLIC UTILITY COMMISSION OF OREGON
STAFF REPORT
PUBLIC MEETING DATE: August 6, 2002**

REGULAR ____ **CONSENT** X **EFFECTIVE DATE** _____

DATE: July 23, 2002

TO: John Savage through Marc Hellman and Rebecca Hathhorn

FROM: Mike Dougherty

SUBJECT: ILLAHE ESTATES WATER SYSTEM, INC.: (Docket No. UI 194)
Application for approval of a management contract with Salem
Development, Inc.

STAFF RECOMMENDATION:

The Commission should approve Illahe Water System Inc.'s (Illahe) application for management service contract with Salem Development, Inc. (SDI), an affiliated interest, and include the following conditions:

1. Illahe shall provide the Commission access to all books of account, as well as documents, data, and records of Illahe's and SDI's affiliated interests that pertain to this transaction.
2. The Commission reserves the right to review for reasonableness all financial aspects of this transaction in any rate proceeding or alternative form of regulation.
3. Illahe shall notify the Commission in advance of any substantive changes to the agreement, including any material change in price. Any such change shall be submitted in an application for a supplemental order (or other appropriate format) in this docket.

DISCUSSION:

Illahe filed this application on January 22, 2002, pursuant to ORS 757.495 and OAR 860-036-0730. Illahe requests authorization from the Commission for SDI to provide management services involving water system operation, engineering, accounting, legal, customer relations, and regulatory matters related to the operations of the water system. Illahe is currently serving 192 customers.

The water system was originally owned and operated by SDI. SDI transferred the water system to Illahe in order to separate its real estate and water businesses into distinct entities. The Oregon Public Utility Commission approved the transfer in Order 01-304, entered April 20, 2001. Therefore, Illahe and SDI are affiliated interests under ORS 757.015.

Per the management service contract, SDI will provide approximately 21 hours a month supervising contracts and providing other management services including dealing with customer complaints and questions, handling emergencies, inspecting the water system, and filing required information, applications, permits with government entities. Illahe agreed to pay SDI a monthly fee of \$1,000 for twelve months totaling \$12,000 annually. The agreement will remain in effect for five years beginning October 1, 2001.

Because Illahe was not aware of any nonaffiliated management companies that would be interested in providing the necessary management services, Illahe did not use a competitive procurement process in obtaining this contract. In the application, Illahe states that the officers and directors of SDI possess the necessary experience and systems knowledge to effectively manage the water system and are able to provide these necessary skills at a lower cost than a nonaffiliated management company.

Staff reviewed the terms of the agreement, the transfer price, records availability, audit provisions and reporting requirements. Staff found that there were no restrictive aspects to this management contract. Illahe is paying approximately \$48 per hour for the management service. Staff compared this cost to comparable costs of management services and determined that Illahe is paying the lower of cost, or market value. Customers are likely not harmed by this transaction because Illahe is paying a fair and reasonable price and meeting the Commission's transfer pricing policy.

After review of the filing, Staff concludes that the application involves an affiliated interest transaction that is fair and reasonable and not contrary to the public interest, with the inclusion of the proposed ordering conditions.

PROPOSED COMMISSION MOTION:

Illahe Water System, Inc.'s UI 194 application to enter into an affiliated interest transaction with Salem Development, Inc, including the three recommended conditions stated in this memorandum be approved.