

**PUBLIC UTILITY COMMISSION OF OREGON
STAFF REPORT
PUBLIC MEETING DATE: December 17, 2002**

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

DATE: December 3, 2002

TO: John Savage through Marc Hellman and Rebecca Hathhorn

FROM: Michael Dougherty

SUBJECT: APACHE WATER COMPANY: (Docket No. UP 198) Application for Approval to Merge Apache Water Company and Agate Water Company.

STAFF RECOMMENDATION:

The Commission should approve Apache Water Company's (Apache) application to merge with Agate Water Company (Agate) with the following conditions:

1. Agate shall provide the Commission access to all books of account, as well as documents, data, and records that pertain to the merger of the water companies.
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. Agate shall notify the Commission in advance of any substantive changes to the merger. Any such change shall be submitted in an application for a supplemental order (or other appropriate format) in this docket.
4. Agate shall file tariffs with the Commission to establish rates for the merged company within one year of the merger approval.

DISCUSSION:

Background

Apache filed this application on September 12, 2002, pursuant to ORS 757.480 and OAR 860-036-0715. Apache seeks a Commission order authorizing the merger of Agate and Apache water companies. Agate and Apache are rate regulated water utilities that serve customers outside the Bend, Oregon city limits.

The merger will be accomplished pursuant to an Agreement between Apache and Yvonne Katter (Agreement), dated August 13, 2002, and a Plan of Merger for Apache and Agate (Plan), dated October 31, 2002. The effective date of the merger is January 1, 2003. The closing date of the merger is January 15, 2003. The surviving entity shall be known as Agate Water System Company, an Oregon corporation.

Apache was co-owned by Fred Schilling and Yvonne Katter. Per the Agreement, Mrs. Katter transferred her interest in Apache (50% of Apache shares) to Apache for \$175,000 to be paid without interest at the rate of \$1,622 per month for a period of 108 months. Fred Schilling is also the principal owner of Agate.

At the effective date of the merger, Apache shareholders will receive stock in Agate at the rate of one new share for each Apache share held by the shareholder. Currently, Apache serves 526 active and 19 in-active residential customers. Agate currently serves 493 active and 24 in-active residential customers.

Issues

Staff investigated the following issues:

1. Scope and Terms of the Merger
2. Public Interest Compliance
3. Records Availability, Audit Provisions and Reporting Requirements

Scope and Terms of Merger – Based upon Staff's analysis of the Agreement and Notice, there appears to be no unusual or restrictive terms that will harm customers. The Apache stock, as of June 30, 2002, was worth \$205,381. Prior to the transfer, Mrs. Katter, as the beneficiary of Mr. Duane Katter, the deceased co-owner of Apache, was receiving a \$1,512 per month pension benefit from Apache. The monthly payments of \$1,622 replace the pension benefit that was being received by Mrs. Katter.

Per OAR 860-036-0710, Apache customers were sent a Notice of Merger on October 31, 2002.

Public Interest Compliance - The purpose of the merger is to capture operation and cost efficiencies resulting from the operation of one company rather than two separate systems. Agate was awarded a Safe Drinking Water Revolving Loan Fund of \$3,505,000 from the Oregon Economic & Community Development Department (OECD) on October 21, 2002. The award is in the amount of \$3,255,000 loan and a

\$250,000 principal forgiveness. Loan payments are due starting December 1, 2003, and will be amortized over 30 years at 1 percent interest.

Monies from this loan will be used to improve system reliability and water quality for both the Apache and Agate systems. By joining the two systems into a looped system, customers will experience increased structural integrity and reliability due to back-up power and piping tie-ins between the two systems. The improvements to the systems should eliminate many of the problems experienced by Agate and Apache customers, including low water pressure during the summer months, lack of fire hydrants and lack of water during power outages.

As a result of the merger, Apache customers will transfer to the Agate rate schedules. This rate transfer will result in an increase of approximately \$5.00 per month based on the average Apache customer use of 1,720 cubic feet per month¹. The following table demonstrates the average increase per usage range for Apache customers.

Usage²	Customer Number	Pre-Merger Cost³	Post-Merger Cost	Average Monthly Increase
Less than 500 CF	48	\$18.72	\$20.42	\$1.70
501 – 1000 CF	62	\$19.77	\$22.15	\$2.38
1001 – 1700 CF	81	\$22.29	\$26.29	\$4.00
1701 – 2500 CF	75	\$27.36	\$35.05	\$7.69
Greater than 2500 CF	260	\$30.96	\$41.45	\$10.49

Although Apache customers will experience a rate increase through the merger, Staff believes that the service benefits of a looped system and the planned improvements to system reliability result in the merger being in the public interest.

As a result of the rate increase for Apache customers, recommended condition No. 4 will require Agate to file for a rate case within one year of the Commission's approval of the merger.

¹ Rates for Apache were established in Commission Order 01-153 (UW 69). Rates for Agate were established in Commission Order 00-237 (UW 72).

² Usage range amounts were taken from the September 2002 actual usage by Apache customers.

³ To determine pre and post merger costs, Staff used the median for each range (ex. 750 CF for the 501 – 1000 CF range). For the less than 500 CF, Staff used 500 CF and for the greater than 2500 CF range, Staff used 2500 CF.

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Records Availability, Audit Provisions and Reporting Requirements - The proposed ordering condition No. 1 provides the necessary records access to Agate's relevant books and records.

After review of the filing, Staff concludes that the application is fair and reasonable and not contrary to the public interest.

PROPOSED COMMISSION MOTION:

Apache Water Company's UP 198 application for authority to merge with Agate Water Company, including the four conditions stated in this memorandum, be approved.