

**PUBLIC UTILITY COMMISSION OF OREGON
STAFF REPORT
PUBLIC MEETING DATE: September 11, 2007**

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

DATE: August 29, 2007

TO: Public Utility Commission

FROM: Marion Anderson

THROUGH: Lee Sparling, Marc Hellman, and Michael Dougherty

SUBJECT: ROATS WATER SYSTEM, INC.: (Docket No. UI 273) Application for an affiliated interest contract between Roats Water System Inc. and William K. Roats.

STAFF RECOMMENDATION:

The Public Utility Commission (PUC or Commission) should approve the application of Roats Water System, Inc. (Roats or the Company) for an affiliated interest agreement with William K. Roats with the following conditions.

1. The Company shall provide the Commission access to all books of account, as well as all documents, data, and records that pertain to any payments to William K. Roats.
2. The Commission reserves the right to review, for reasonableness, all financial aspects of this arrangement in any rate proceeding or earnings review under an alternative form of regulation.
3. The Company shall notify the Commission in advance of any substantive changes to the agreement, including any material changes in any cost. Any changes to the agreement terms that alter the intent and extent of activities under the agreement from those approved herein, shall be submitted for approval in an application for a supplemental order (or other appropriate format) in this docket.
4. Total 2007 compensation payments to William K. Roats including salary, health, and retirement benefits shall not exceed \$101,473.

5. The Company may escalate both the salary and compensation amounts listed in the previous condition on an annual basis at a percentage not to exceed the annual Consumers Price Index – All Urban Consumers (CPI-U) published by the U.S. Bureau of Labor Statistics (BLS).

DISCUSSION:

This application was filed on July 13, 2007, pursuant to ORS 757.015 and 757.495, and OAR 860-036-0730. William K. Roats and his wife own the Company; therefore, an affiliated interest relationship exists.

This application is a revision to traditional Staff policy on owner utility employment. Precedent for owner employment services agreements was set in Docket UW 117. The Commission clarified the requirements relating to situations where owners of water utilities were also employed by the utility. Staff had historically not requested an affiliated interest filing in such circumstances and instead rigorously reviewed the compensation expense during general rate reviews. The Commission found that the plain, natural, and ordinary meaning of the affiliated interest statute mandates that payment of wages and benefits to an owner of a utility requires an affiliated interest filing, pursuant to ORS 757.495(1).

The following issues were investigated:

- Scope of the Agreement
- Transfer Pricing
- Determination of Public Interest Compliance
- Records Availability, Audit Provisions, and Reporting Requirements

Scope of the Agreement

Staff requested and received a position description for William K. Roats as follows:

The full-time position of President/CEO which is held by William K. Roats includes responsibilities of managing, planning, coordinating, and administering all activities of the Roats Water System, Inc. William K. Roats is responsible for the short and long range strategy of the organization. He is responsible for the Water Development planning and Hydraulic System planning. In addition, he is responsible for the Capital Program development both for the long and short range. He also directs and administers the Operations/Maintenance Division, functions of Source and Supply, Water Quality, Water Control, Transmission and Distribution, and Maintenance and

Process Control. William K. Roats has worked for the Company for over 40 years, with 18 of these years as President/CEO.

The Roats employee base consisted of six full-time and six part-time individuals in 2006 for 1,432 ratepayers, the Company's largest customer base in the past five years. The Company's 2006 total revenue was \$788,185, and 2006 rate base (excluding contributions in aid of construction) was \$782,507. The Commission's Consumer Services Section has only received a total of two customer complaints on the Company in 2006 and 2007.

Transfer Pricing

Pursuant to OAR 860-036-0739, Allocation of Costs by a Water Utility, when services or supplies are sold to a water utility by an affiliate, sales shall be recorded in the water utility's accounts at the affiliate's cost or the market rate whichever is lower. Given the nature of this application, Staff's review will focus on market rate analysis since cost and market are essentially the same.

The annual compensation requested in the application was \$116,480. The American Water Works Association (AWWA) was cited by the Company and Staff used the AWWA salary survey for Top Operations and Maintenance Executives, Top Planning Executive, and Top Engineering Executive of 25 or fewer employees for a blended market valuation determination. That survey uses three quotations per position; Minimum, Mid-Point, and Maximum. The following table highlights the AWWA compensation survey for the three positions.

	Minimum	Mid-Point	Maximum
Top Planning Executive	\$69,185	---	\$93,208
Top Operations Executive	\$61,336	\$70,776	\$84,989
Top Engineering Executive	\$70,949	\$76,952	\$98,430
Average (Blended)	\$67,156	\$73,864	\$92,209

Given the aforementioned employment description, William K. Roats' experience, and the Company size, Staff recommends the Maximum annual blended salary rate of \$92,209. The recommended amount is reasonable given Roat's significant growth (40 percent in the past five years), cost pressures associated with the rapid growth, the Company's excellent customer service, and the fact that the Company's President/CEO entails responsibilities for all three of the above positions.

The Company offers health and retirement benefits to all full-time employees of Roats. The 2006 cost for William K. Roats for benefits and retirement was \$9,264. As a result, total 2007 compensation payments to William K. Roats, including health and retirement

benefits, shall not exceed \$101,473. Per Staff Recommendation Condition No. 5, the Company may escalate the total compensation on an annual basis at a percentage not to exceed the annual CPI-U as published by the BLS.

Determination of Public Interest Compliance

With the inclusion of Staff's recommended conditions, the employment services agreement is fair and reasonable and not contrary to the public interest.

Records Availability, Audit Provisions, and Reporting Requirements

Staff Recommendation Condition No. 1 affords necessary access to any relevant records.

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

1. The arrangement's scope is reasonable.
2. The contract, as modified by Staff, will not harm customers and is not contrary to the public interest with the recommended conditions.
3. Necessary records are available.

PROPOSED COMMISSION MOTION:

Roats Water System, Inc.'s modified affiliated interest agreement with William K. Roats be approved, subject to the recommended conditions.